

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

25 Jul 2023

BUY

Last Traded Price (24 Jul 2023): S\$2.27 (STI : 3,265.14)

Price Target 12-mth: S\$2.45 (8% upside) (Prev S\$2.35)

Analysts

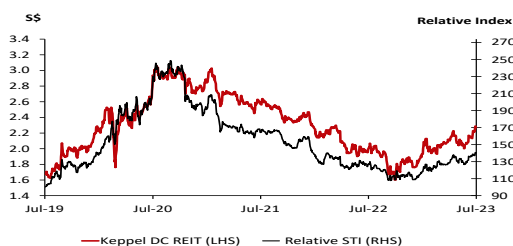
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What's New

- Revenues and NPI increased by more than 3% y-o-y
- 1H23 DPU of 5.051 Scts.; in line with our FY23 projections
- Final payment for Guangdong DC 3 to be accompanied with another accretive acquisition and equity fundraising
- Maintain BUY with a revised TP of S\$2.45

Price Relative



Forecasts and Valuation

FY Dec (\$m)	2022A	2023F	2024F	2025F
Gross Revenue	277	320	338	351
Net Property Inc	253	274	290	301
Total Return	231	179	187	195
Distribution Inc	185	182	190	198
EPU (S cts)	9.47	10.3	10.6	11.1
EPU Gth (%)	(2)	9	3	4
DPU (S cts)	10.2	10.00	10.3	10.7
DPU Gth (%)	4	(2)	3	4
NAV per shr (S cts)	140	143	143	144
PE (X)	24.0	22.1	21.4	20.5
Distribution Yield (%)	4.5	4.4	4.5	4.7
P/NAV (x)	1.6	1.6	1.6	1.6
Aggregate Leverage (%)	35.9	35.7	35.7	35.7
ROAE (%)	6.9	7.3	7.4	7.7

Distn. Inc Chng (%)		0	(2)	(2)
Consensus DPU (S cts)		10.3	10.8	11.5
Other Broker Recs:		B: 7	S: 1	H: 6

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

Where will the next accretive acquisition come from?

Investment Thesis:

Keppel DC REIT has a portfolio of quality DCs in major markets. KDCREIT's portfolio of data centres (DCs) in APAC and Europe continue to benefit from the structural tailwinds of the sector. Its reputation and capability to manage DC assets is reflected in its consistently high occupancy rates. In addition, KDCREIT benefits from the support of its sponsor, which provides it with pipeline assets and DC development capabilities to further grow its portfolio.

Accretive acquisitions and AELs to drive organic growth. Accretive acquisitions over the past year will drive earnings, and recently completed AELs will generate organic growth. For FY23, the full-year contribution from acquisitions will support earnings growth, and the protracted completion of Guangdong DC 3 will lead to a higher income contribution from the asset.

Resumption of accretive acquisitions will be the main catalyst.

Although KDCREIT continued its acquisitions over the past year, the rate at which it does this has slowed down notably due to stubbornly low cap rates and rising financing costs. As such, we have not priced any acquisition assumptions into our estimates. But with interest rate hikes seeming to have slowed and potentially stabilising, KDCREIT could resume accretive acquisitions in the near future.

BUY recommendation with a higher TP of S\$2.45 (vs. S\$2.35 previously). As such, we will be maintaining our BUY recommendation, with an upward revision in our TP to S\$2.45, implying forward yields of c.4.1%-4.4% (in line with the historical average). Further catalysts to our projections will come from accretive acquisitions as well as a lower-than-projected rise in financing cost, although we note that equity fundraising could be a risk in the near term.

Key Risks

With indications that accretive acquisitions will resume in the near term, KDCREIT could look to embark on equity fundraising to partly fund further acquisitions.

At A Glance

Issued Capital (m shrs)	1,720
Mkt. Cap (S\$m/US\$m)	3,904 / 2,934
Major Shareholders (%)	
Keppel Corp Ltd	20.4
BlackRock Inc	7.5
Vanguard Group Inc/T	2.4
Free Float (%)	72.1
3m Avg. Daily Val (US\$m)	8.2
GIC Industry : Real Estate / Equity Real Estate Investment (REITs)	



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WHAT'S NEW**Where will the next accretive acquisition come from?****1H23 revenues and NPI increased 3.6% and 3.3%, respectively**

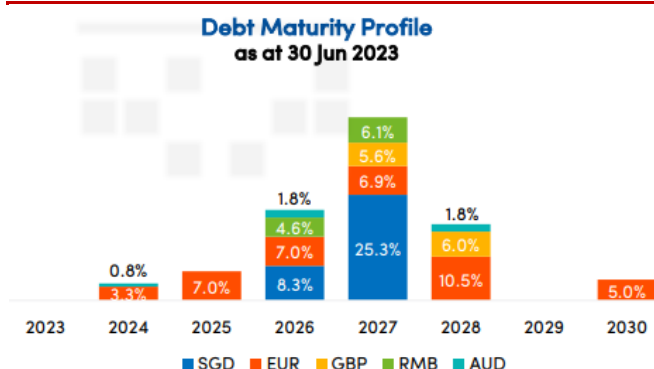
- Revenues and NPI increased y-o-y mainly due to contributions from Guangdong DC 2 and 3, and organic growth from renewals and income escalations
 - Partially offset by lower contributions from Singapore colocation assets due to higher operating costs (higher electricity costs)
 - Guangdong DC 2 and 3 were acquired on 12 August 2022
- 1H23 DI remained relatively flat y-o-y at S\$91.3m, a 0.2% increase y-o-y
 - Higher revenues were offset mainly by higher financing costs, lower contributions from Singapore colocation assets, lower government incentives for investments in Guangdong, and FX
 - All-in interest rates in 2Q23 increased by 50bps, mainly due to the refinancing of the c.S\$74m EUR loan due this year
 - S\$1m in tax savings was recognised in 1H23; relates to tax savings in FY22 for the QPDS status obtained for the NetCo bonds
 - Savings of 17% in corporate taxes
 - One-off pay out of tax savings

1H23 DPU of 5.051 Scts, in line with our projections

- 1H23 DPU remained fairly flat y-o-y and h-o-h
 - Makes up c.51% of our FY23 estimates
- We believe that KDCREIT will be able to maintain 2H23 DPU at these levels
 - Rental growth and higher portfolio occupancy rates to drive sustained organic growth; offset higher financing costs

Financing costs increased 50bps in 2Q23

- Overall cost of debt for 2Q23 was 3.3%, a 50bps increase q-o-q
 - Average YTD financing cost was 3.1%, a 30bps increase compared to 1Q23
 - Increase in borrowing costs mainly due to the c.S\$74m EUR loan that was refinanced during the quarter
- Overall financing costs for the rest of this year are expected to remain relatively stable at the current levels
 - No more refinancing required for the rest of FY23
 - Only 4.0% of outstanding loans (c.S\$60m) due for refinancing in FY24 (EUR and AUD loans)
 - Likely to lead to further increase in all-in financing costs, but increase will be minimal
- 73% of loans remains hedged to fixed rates
 - Mitigates any spikes in overall financing costs
- A further 100bps increase in interest rates will lead to a c.2.2% downside to earnings

Next refinancing only due in FY24

Source: Keppel DC REIT

Maintained strong portfolio occupancy at 98.5%

- Portfolio occupancy rates remain strong at 98.5%
- Only 12.2% of leases (by GRI) remains to be renewed for the rest of FY23
- There will be a further 23.4% of leases that will be due for renewal in FY24
- New and renewal leases in 1H23 came from Singapore, Ireland, and the Netherlands
 - Led to overall strong double-digit positive reversions
- Cyxtera lease with KDCREIT in London isn't impacted by ongoing Chapter 11 filing of Cyxtera's business in the US
 - Cyxtera's European entity is separate; they are current with their rents
- Ongoing litigation with DXC where provisions totalling S\$14.8m for a four-year period have already been made
 - No updates on the litigation
 - Any recovery from these provisions made will be an upside to earnings

Guangdong DC 3 on track for completion in 3Q23

- Development of property is on track and vendor is currently working on fully fitting out the asset
- Continues to receive coupon income from the sums that have already been paid down
- C.S\$140m remains to be paid once the Guangdong DC 3 development is complete
 - We have already assumed c.S\$90m in equity fundraising to fulfil the remaining payment
- Any equity fundraising will potentially be coupled with another acquisition
 - Given KDCREIT's cost of funding, further acquisitions will likely be accretive
 - However, we have not baked any other acquisition assumptions into our projections; further acquisitions will likely lead to an upside to our forecasts

Our thoughts

While there has been a 28% rally in KDCREIT's share price since the beginning of the year, we believe there remains upside to its share price. **Our earnings projections are relatively conservative**, as we have not assumed any further **acquisitions, which will likely be accretive to earnings**.

We have **rolled forward our DCF valuation to FY24**, which will reflect the full-year contribution from the impending completion of Guangdong DC 3. Based on our forecasts, KDCREIT is projected to generate **a c.4% DPU CAGR over the next two years** (to FY25), and **any acquisitions will lead to an upside to our estimates**. KDCREIT benefits from being one of the only few S-REITs that has the potential to **carry out DPU-accretive acquisitions** despite the high interest rates currently.

With the rolling forward of our valuation, we maintain our **BUY** recommendation with a revised TP of **S\$2.45**.

Company Background

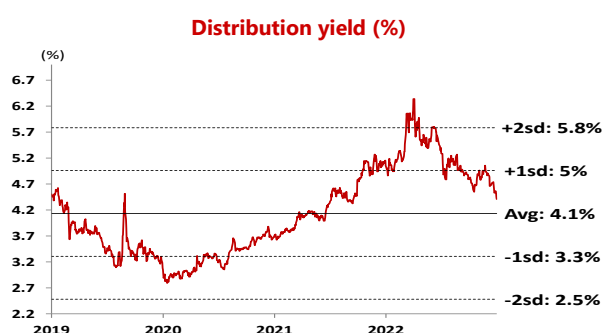
KDC REIT (KDC REIT) is a Singapore-based real estate investment trust (REIT). It was established with the principal investment strategy of investing, directly or indirectly, in a portfolio of income-producing real estate assets that are used primarily for data centre purposes, with an initial focus on Asia Pacific and Europe.

Interim Income Statement (S\$m)

FY Dec	1H2022	2H2022	1H2023	% chg yoy	% chg hoh
Gross revenue	136	142	140	3.6	(0.9)
Property expenses	(12.3)	(12.5)	(13.1)	6.6	5.1
Net Property Income	123	129	127	3.3	(1.5)
Other Operating expenses	(11.2)	(13.6)	(18.0)	59.7	31.8
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	-	-
Associates & JV Inc	0.0	(9.0)	(2.4)	nm	(73.2)
Net Interest (Exp)/Inc	(9.0)	(12.8)	(17.2)	(91.2)	(33.7)
Exceptional Gain/(Loss)	0.0	0.0	0.0	-	-
Net Income	103	93.9	89.8	(12.8)	(4.3)
Tax	(9.1)	(21.9)	(7.8)	(14.2)	(64.3)
Minority Interest	(1.5)	(1.7)	(1.6)	(2.7)	(8.2)
Net Income after Tax	92.4	70.2	80.4	(12.9)	14.5
Total Return	92.4	139	80.4	(12.9)	(41.9)
Non-tax deductible Items	(1.2)	(44.8)	10.9	(997.4)	(124.3)
Net Inc available for Dist.	91.2	93.7	91.3	0.2	(2.6)
Ratio (%)					
Net Prop Inc Margin	90.9	91.2	90.7		
Dist. Payout Ratio	100.0	100.0	100.0		

Source of all data: Company, DBS Bank

Historical Distribution 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	2021A	2022A	2023F	2024F	2025F
Gross revenue	271	277	320	338	351
Property expenses	(22.9)	(24.8)	(45.9)	(48.2)	(49.9)
Net Property Income	248	253	274	290	301
Other Operating expenses	(31.3)	(33.5)	(35.9)	(36.6)	(37.2)
Other Non Opg (Exp)/Inc	4.40	8.63	0.0	0.0	0.0
Associates & JV Inc	(1.0)	(9.0)	0.0	0.0	0.0
Net Interest (Exp)/Inc	(20.7)	(21.8)	(32.4)	(38.4)	(39.4)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Net Income	200	197	205	215	224
Tax	(29.2)	(31.0)	(22.9)	(24.0)	(25.0)
Minority Interest	(7.9)	(3.3)	(3.6)	(4.0)	(4.4)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Income After Tax	162	163	179	187	195
Total Return	314	231	179	187	195
Non-tax deductible Items	(142)	(46.0)	3.35	3.22	3.26
Net Inc available for Dist.	172	185	182	190	198
Growth & Ratio					
Revenue Gth (%)	2.1	2.3	15.2	5.9	3.8
N Property Inc Gth (%)	1.6	1.8	8.4	6.0	3.8
Net Inc Gth (%)	(3.0)	0.1	10.0	4.6	4.3
Dist. Payout Ratio (%)	94.7	95.0	94.8	95.0	95.1
Net Prop Inc Margins (%)	91.5	91.1	85.6	85.8	85.8
Net Income Margins (%)	59.9	58.6	56.0	55.3	55.6
Dist to revenue (%)	63.3	66.7	57.0	56.3	56.5
Managers & Trustee's fees	11.6	12.1	11.2	10.8	10.6
ROAE (%)	7.7	6.9	7.3	7.4	7.7
ROA (%)	4.6	4.1	4.3	4.3	4.5
ROCE (%)	5.3	4.8	5.1	5.3	5.5
Int. Cover (x)	10.5	10.0	7.3	6.6	6.7

Revenue growth mainly driven by positive rental reversions, full-year contribution from Guangdong DC 2, and one quarter's contribution from Guangdong DC 3.

Source: Company, DBS Bank

Interim Income Statement (\$m)

FY Dec	1H2021	2H2021	1H2022	2H2022	1H2023
Gross revenue	135	136	136	142	140
Property expenses	(11.3)	(11.6)	(12.3)	(12.5)	(13.1)
Net Property Income	124	124	123	129	127
Other Operating	(14.4)	(12.5)	(11.2)	(13.6)	(18.0)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	0.0	(1.0)	0.0	(9.0)	(2.4)
Net Interest (Exp)/Inc	(10.1)	(10.6)	(9.0)	(12.8)	(17.2)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Net Income	99.4	100	103	93.9	89.8
Tax	(9.1)	(20.1)	(9.1)	(21.9)	(7.8)
Minority Interest	(1.6)	(6.3)	(1.5)	(1.7)	(1.6)
Net Income after Tax	88.7	73.8	92.4	70.2	80.4
Total Return	87.5	226	92.4	139	80.4
Non-tax deductible Items	(3.3)	(139)	(1.2)	(44.8)	10.9
Net Inc available for Dist.	84.3	87.4	91.2	93.7	91.3
Growth & Ratio					
Revenue Gth (%)	(5)	1	0	5	(1)
N Property Inc Gth (%)	(5)	0	(1)	5	(2)
Net Inc Gth (%)	4	(17)	25	(24)	15
Net Prop Inc Margin (%)	91.6	91.5	90.9	91.2	90.7
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0	100.0

S\$1m in tax savings from FY22 due to the approval of NetCo bonds as QPDS.

Balance Sheet (\$m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Investment Properties	3,401	3,639	3,793	3,805	3,817
Other LT Assets	117	206	206	206	206
Cash & ST Invt	196	190	209	221	235
Inventory	0.0	0.0	0.0	0.0	0.0
Debtors	50.4	61.4	78.8	83.4	86.6
Other Current Assets	15.9	10.8	10.8	10.8	10.8
Total Assets	3,780	4,108	4,296	4,326	4,355
ST Debt	163	175	175	175	175
Creditor	50.1	62.6	70.0	74.2	76.9
Other Current Liab	7.43	6.57	22.9	24.0	25.0
LT Debt	1,136	1,300	1,359	1,370	1,381
Other LT Liabilities	87.6	106	106	106	106
Unit holders' funds	2,293	2,414	2,516	2,525	2,535
Minority Interests	42.4	42.8	46.4	50.4	54.8
Total Funds & Liabilities	3,780	4,108	4,296	4,326	4,355
Non-Cash Wkg. Capital	8.68	2.99	(3.3)	(3.9)	(4.6)
Net Cash/(Debt)	(1,103)	(1,285)	(1,326)	(1,324)	(1,321)
Ratio					
Current Ratio (x)	1.2	1.1	1.1	1.2	1.2
Quick Ratio (x)	1.1	1.0	1.1	1.1	1.2
Aggregate Leverage (%)	34.4	35.9	35.7	35.7	35.7
Z-Score (X)	2.8	2.9	2.9	2.9	2.9

Assumed c.\$90m in equity raised in 3Q23 for the remaining payment of Guangdong DC 3 once the development is completed.

Source: Company, DBS Bank

Cash Flow Statement (\$\$m)

FY Dec	2021A	2022A	2023F	2024F	2025F
Pre-Tax Income	200	197	205	215	224
Dep. & Amort.	0.0	0.0	0.0	0.0	0.0
Tax Paid	(7.0)	(6.5)	(6.6)	(22.9)	(24.0)
Associates & JV Inc/(Loss)	1.00	8.98	0.0	0.0	0.0
Chg in Wkg.Cap.	(21.9)	(4.4)	(10.0)	(0.5)	(0.3)
Other Operating CF	(142)	(46.0)	3.35	3.22	3.26
Net Operating CF	29.7	149	192	195	203
Net Invnt in Properties	(282)	(295)	(153)	(11.8)	(12.3)
Other Invnts (net)	(26.4)	0.0	0.0	0.0	0.0
Invnts in Assoc. & JV	(89.7)	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	23.6	(3.7)	0.0	0.0	0.0
Net Investing CF	(374)	(299)	(153)	(11.8)	(12.3)
Distribution Paid	(185)	(150)	(173)	(181)	(189)
Chg in Gross Debt	143	266	59.7	10.5	11.0
New units issued	202	0.0	92.3	0.0	0.0
Other Financing CF	(24.8)	(33.1)	0.0	0.0	0.0
Net Financing CF	135	83.7	(20.8)	(170)	(178)
Currency Adjustments	(0.5)	(8.8)	0.0	0.0	0.0
Chg in Cash	(210)	(75.0)	18.2	12.9	13.5
Operating CFPS (S cts)	3.08	8.93	11.6	11.1	11.6
Free CFPS (S cts)	(15.1)	(8.5)	2.24	10.4	10.9

Source: Company, DBS Bank

Target Price & Ratings 12-mth 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:	26 Jul 22	2.02	2.50	BUY
2:	27 Oct 22	1.78	2.20	BUY
3:	01 Feb 23	2.11	2.35	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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2. DBS Bank Ltd, DBS HK, DBSVS, DBSVUSA, or their subsidiaries and/or other affiliates have a net long position exceeding 0.5% of the total issued share capital in Keppel DC REIT recommended in this report as of 30 Jun 2023.
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