Singapore Company Guide

Keppel DC REIT

derEdition 1 Version 1 | Bloomberg: KDCREIT SP | Reuters: KEPE.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

16 Oct 2015

BUY

Last Traded Price: S$1.05 (**STI :** 3,015.14)
Price Target : S$1.14 (9% upside)

Potential Catalyst: Acquisitions
Where we differ: In line with consensus

Analyst
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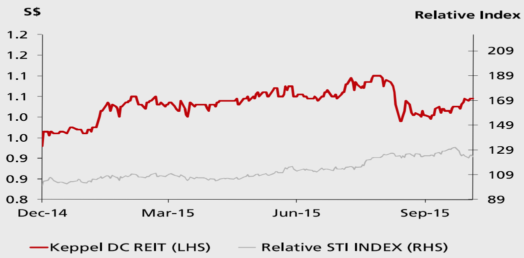
Price Relative



Forecasts and Valuation

FY Dec (S$ m)	2014A	2015F	2016F	2017F
Gross Revenue	80	97	124	129
Net Property Inc	67	80	105	109
Total Return	48	56	75	79
Distribution Inc	48	57	75	80
EPU (S cts)	5.4	6.4	7.5	7.1
EPU Gth (%)	nm	18	18	(5)
DPU (S cts)	5.4	6.4	6.8	7.2
DPU Gth (%)	nm	18	6	6
NAV per shr (S cts)	87.5	87.5	89.8	89.8
PE (X)	19.3	16.4	13.9	14.6
Distribution Yield (%)	5.2	6.1	6.5	6.9
P/NAV (x)	1.2	1.2	1.2	1.2
Aggregate Leverage (%)	31.2	34.3	30.1	30.3
ROAE (%)	6.1	7.3	8.5	8.0
Distn. Inc Chng (%):		(1)	21	21
Consensus DPU (S cts):		6.8	7.1	7.3
Other Broker Recs:		B: 2	S: 0	H: 1

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

DATA CENTRE REIT WITH BIG AMBITIONS

Riding on the global data boom. Keppel DC REIT offers investors unique exposure into the highly specialised and resilient data centre market. With close to 70% of NPI derived from co-location leases, the Trust is poised to ride on rising global usage of data and demand for data centres. Earnings are further supported by its master leased properties (30% of NPI) which have average annual escalations of 2-4%.

Visible earnings growth profile underpinned by acquisition potential. With foreign sourced distributions fully hedged until 1H17, and 90% of borrowings hedged into fixed rate debt, Keppel DC REIT stands out for its stable and highly visible earnings profile. Earnings catalyst will come from the acquisition of T27, which we believe could occur in 1H16. While an acquisition of >S$250m is expected to trigger an equity fund raising exercise, we believe the acquisition will be accretive to earnings given that the stock is trading at a low implied cap rate of 6.3%

Imputed S$250m of acquisitions into FY16 numbers. We have assumed S$250m of acquisitions in FY16 to account for the purchase of T27; we have assumed the equity fundraising will bring gearing down to 30%, which is the Manager's long term target level.

Valuation:

We currently have a BUY recommendation, with DCF-backed TP of S$1.14. The stock offers attractive yields 6.5% for FY16 and upside will hinge on better than expected returns from acquisitions, or higher occupancies at co-location properties.

Key Risks to Our View:

Higher maintenance capex relative to other asset classes. Keppel DC REIT is responsible for maintenance capex for certain properties in the portfolio. Due to the shorter lifespan of a data centre's infrastructure, it is possible that the REIT may have to rely on borrowings to fund these works, which would result in higher gearing levels, or there could be some pressure on the REIT's cash flow, potentially affecting its ability to pay distributions.

At A Glance

Issued Capital (m shrs)	883
Mkt. Cap (Sm/USm)	923 / 669
Major Shareholders	
Keppel Telecom & Transport (%)	30.1
Wellington Management (%)	7.3
Free Float (%)	62.6
3m Avg. Daily Val (US$m)	1.4

ICB Industry : Financials / Real Estate Investment Trusts

CRITICAL DATA POINTS TO WATCH

Earnings Drivers:

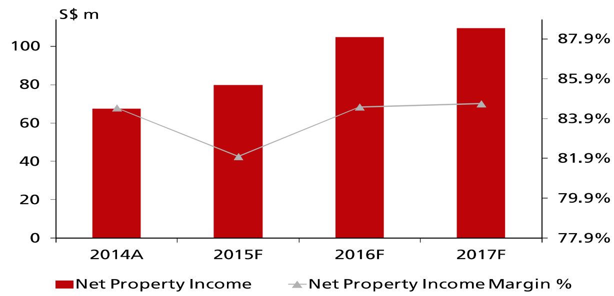
Tapping on global data storage and usage growth. As an owner of data centres in key data gateways and financial centres across Asia Pacific and Europe, Keppel DC REIT is poised to ride the wave of rising global data usage and demand for data centres. The Trust offers investors a stable and visible earnings growth profile, with 30% of NPI derived from long-dated master leases with embedded rental step-ups of 2-4% p.a. With 61% of leases by rental income due for renewal between 2015 and 2017, earnings will be further driven by positive rental reversions and higher occupancies at its co-location data centres in Singapore (T25, S25), Australia (part of Gore Hill), and Ireland (Citadel 100). As it stands, the Trust has a WALE of 2.6 years for co-location properties, 9.9 years for fully fitted properties, and 16 years for shell & core properties.

Strong ambitions to grow portfolio; pricing in S$250m worth of acquisitions. We have assumed S$250m of acquisitions in FY16 to account for the purchase of T27, which will be funded via a mix of debt and equity. In addition, the Manager remains on a constant lookout for third party acquisitions in Europe (Germany, France, Ireland) and the Asia Pacific (China, Indonesia, Korea, Japan, Australia) to grow the REIT's portfolio and drive earnings. In addition, the REIT currently has the rights of first refusal (ROFR) over three other assets owned by Keppel T&T and/or iSeek Communications in Singapore, Netherlands and Australia.

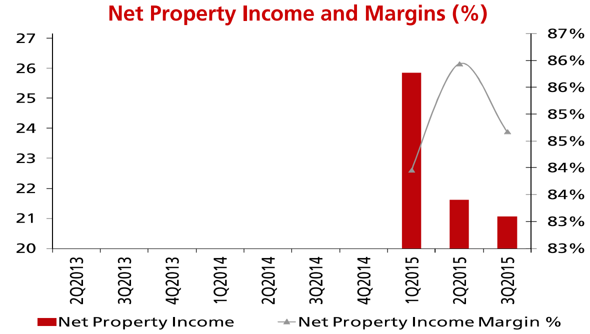
3Q15 results beat IPO forecasts by 2.2%. Distributable income beat prospectus forecasts by 2.2% on the back of (a) contribution from the recently acquired Intellicentre 2, (b) lower than expected interest costs, as well as (c) realisation of currency hedging gains.DPU came in at 1.64Scts, although this will not be paid out until 4Q15 as the REIT has a half-yearly payout policy.

Occupancy rate for DC space the key metric to watch. In 3Q15, the Trust signed 2 renewal and expansion leases, as well as 4 new leases, amounting to a total of c.98k sqft of NLA. However we note that majority of leasing activity was for work space (as opposed to DC space), where rents are much lower compared to DC space. Occupancy at S25 dipped marginally to 85.7%, as one tenant declined to take up an expansion space allocated to it within the data centre. Overall, the Manager commented that tenants are a little more reticent in signing new or renewal leases, due to more competition from other data centre providers entering the market. Occupancy at Citadel improved to 80.3%, mostly due to new leases for work space. We understand that leasing the remaining 20% of DC space will be more difficult however, as Dublin (where Citadel 100 is locatedis still experiencing some overcapacity issues and the leasing outlook remains challenging.

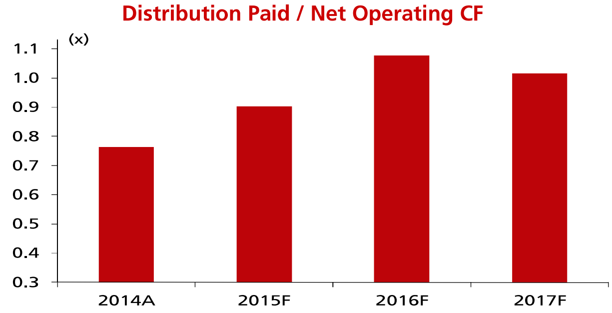
Net Property Income and Margins (%)



Net Property Income and Margins (%)



Distribution Paid / Net Operating CF



Source: Company, DBS Bank

Balance Sheet:

Conservative hedging policies. Major currencies that will impact earnings - AUD and EUR - have been hedged for 2 years at better than current spot rates, minimising any currency fluctuations going forward. While the Manager has hedged majority of its foreign-sourced income until 1H17, we note that the REIT could face translation losses upon rolling forward these hedges if the AUD and EUR remain at current levels.

Conservative balance sheet. Keppel DC REIT's gearing stands at c.30%, with an all-in cost of debt of 2.5% and debt tenure of 3.4 years. As at end-3Q15, 90% of the Trust's borrowings are hedged into fixed rate debt, which will provide earnings visibility in a volatile interest rate environment. Going forward, the Manager intends to maintain a 30/70% debt/equity for future acquisitions, in order to maintain a long term gearing target of 30%.

Share Price Drivers:

Surprise from acquisitions. Given management's ambitions to grow the portfolio, expectations remain high that Keppel DC REIT will remain on an acquisition growth path. With the stock trading at an implied cap rate of 6.3%, and coupled with target yields of c.7-8%, we believe the successful execution of such growth plans is likely to translate as upside to distributions and share price.

Potential for earnings upside from higher reversions at co-location data centres. We estimate that Keppel DC REIT derives close to 70% of its NPI from co-location data centres; namely, S25 and T25 in Singapore, Citadel 100 in Ireland, and part of Gore Hill in Sydney. Our current earnings forecasts impute c.100% occupancy rates for Citadel 100 and S25; higher occupancy rates at these properties would provide a boost to distributions and share price.

Key Risks:

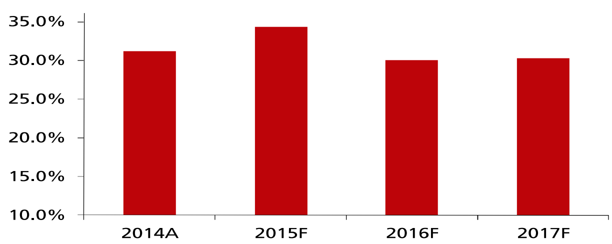
Higher maintenance capex relative to other asset classes. Due to the shorter lifespan of a data centre's infrastructure, it is possible that the REIT may have to rely on borrowings to fund maintenance capex at certain properties which could impact gearing.

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 Keppel DC REIT has a presence. Keppel DC REIT may face higher barriers to entry and stiffer competition to attract and retain tenants.

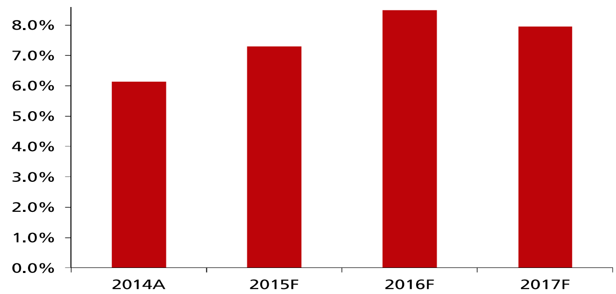
COMPANY BACKGROUND

Keppel DC REIT is a Singapore-based real estate investment trust (REIT), 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.

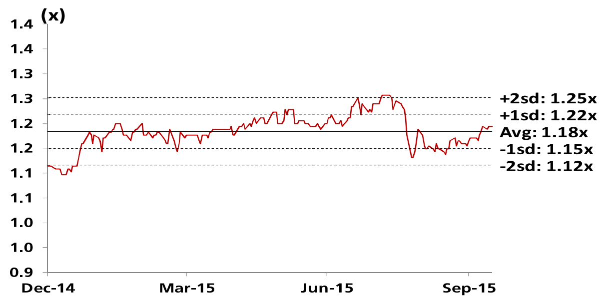
Aggregate Leverage (%)



ROE (%)



PB Band (x)



Source: Company, DBS Bank

Income Statement (S$ m)

FY Dec	2014A	2015F	2016F	2017F
Gross revenue	80	97	124	129
Property expenses	(12)	(18)	(19)	(20)
Net Property Income	**67**	**80**	**105**	**109**
Other Operating expenses	(9)	(12)	(14)	(14)
Other Non Opg (Exp)/Inc	0	0	0	0
Net Interest (Exp)/Inc	(8)	(9)	(11)	(11)
Exceptional Gain/(Loss)	0	0	0	0
Net Income	**50**	**59**	**80**	**84**
Tax	(3)	(3)	(4)	(5)
Minority Interest	0	0	0	0
Preference Dividend	0	0	0	0
Net Income After Tax	**48**	**56**	**75**	**79**
Total Return	48	56	75	79
Non-tax deductible Items	0	0	0	0
Net Inc available for Dist.	48	57	75	80
Growth & Ratio				
Revenue Gth (%)	N/A	21.9	27.1	4.4
N Property Inc Gth (%)	nm	18.4	31.0	4.6
Net Inc Gth (%)	nm	17.7	33.5	5.6
Dist. Payout Ratio (%)	100.0	100.0	100.0	100.0
Net Prop Inc Margins (%)	84.4	82.0	84.5	84.6
Net Income Margins (%)	59.9	57.8	60.7	61.4
Dist to revenue (%)	59.9	58.1	60.9	61.6
Managers & Trustee's fees to sales %)	11.3	11.9	11.2	10.9
ROAE (%)	6.1	7.3	8.5	8.0
ROA (%)	4.3	4.9	5.8	5.6
ROCE (%)	5.1	5.8	6.7	6.4
Int. Cover (x)	7.3	7.3	8.1	8.4

Source: Company, DBS Bank

Growth to be driven by (a) acquisitions, (b) higher rentals and occupancies from co-location data centres, and (c) annual rental escalations from master leased properties.

Quarterly / Interim Income Statement (S$ m)

FY Dec	1Q2015	2Q2015	3Q2015
Gross revenue	31	26	25
Property expenses	(5)	(4)	(4)
Net Property Income	26	22	21
Other Operating expenses	(3)	(3)	(1)
Other Non Opg (Exp)/Inc	0	0	0
Net Interest (Exp)/Inc	(4)	(3)	(3)
Exceptional Gain/(Loss)	(1)	0	0
Net Income	**19**	**17**	**18**
Tax	(1)	(1)	(1)
Minority Interest	0	0	0
Net Income after Tax	**17**	**15**	**17**
Total Return	17	15	17
Non-tax deductible Items	0	(1)	(2)
Net Inc available for Dist.	17	14	14
Growth & Ratio			
Revenue Gth (%)	N/A	(18)	(1)
N Property Inc Gth (%)	nm	(16)	(3)
Net Inc Gth (%)	nm	(10)	10
Net Prop Inc Margin (%)	84.0	85.9	84.7
Dist. Payout Ratio (%)	100.0	100.0	100.0

DPU came in at 1.64Scts, but this will not be paid out this quarter as the REIT pays out dividends on a half yearly basis.

Balance Sheet (S$ m)

FY Dec	2014A	2015F	2016F	2017F
Investment Properties	1,047	1,098	1,352	1,356
Other LT Assets	2	2	2	2
Cash & ST Invts	26	32	26	25
Inventory	0	0	0	0
Debtors	47	32	41	43
Other Current Assets	0	0	0	0
Total Assets	**1,122**	**1,164**	**1,421**	**1,426**
ST Debt	4	4	4	4
Creditor	18	6	8	9
Other Current Liab	0	3	4	5
LT Debt	323	373	402	407
Other LT Liabilities	4	4	4	4
Unit holders' funds	773	773	998	998
Minority Interests	0	0	0	0
Total Funds & Liabilities	**1,122**	**1,164**	**1,421**	**1,426**
Non-Cash Wkg. Capital	29	23	29	30
Net Cash/(Debt)	(301)	(345)	(380)	(386)
Ratio				
Current Ratio (x)	3.4	4.9	4.1	4.0
Quick Ratio (x)	3.4	4.9	4.1	4.0
Aggregate Leverage (%)	31.2	34.3	30.1	30.3

We have assumed S$250m worth of acquisitions at 7.5% yield, in 2016.

Gearing to rise gradually as maintenance capex (est. S$4m p.a.) is funded via debt.

Source: Company, DBS Bank

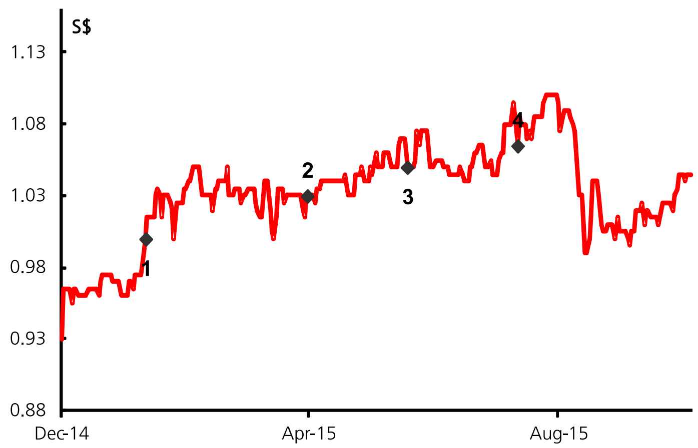
Cash Flow Statement (S$ m)

FY Dec	2014A	2015F	2016F	2017F
Pre-Tax Income	50	59	80	84
Dep. & Amort.	0	0	0	0
Tax Paid	0	0	(3)	(4)
Associates &JV Inc/(Loss)	0	0	0	0
Chg in Wkg.Cap.	0	3	(7)	(1)
Other Operating CF	(16)	0	0	0
Net Operating CF	**34**	**63**	**70**	**78**
Net Invt in Properties	(430)	(50)	(254)	(5)
Other Invts (net)	(1)	0	0	0
Invts in Assoc. & JV	0	0	0	0
Div from Assoc. & JVs	0	0	0	0
Other Investing CF	(44)	0	0	0
Net Investing CF	**(475)**	**(50)**	**(254)**	**(5)**
Distribution Paid	(26)	(57)	(75)	(80)
Chg in Gross Debt	88	50	29	5
New units issued	507	0	225	0
Other Financing CF	(120)	0	0	0
Net Financing CF	**449**	**(6)**	**179**	**(75)**
Currency Adjustments	0	0	0	0
Chg in Cash	8	6	(5)	(1)
Operating CFPS (S cts)	3.9	6.7	7.7	7.2
Free CFPS (S cts)	(44.8)	1.4	(18.5)	6.7

We have assumed an equity fund raising structure that results in final gearing of 30% post acquisition.

Source: Company, DBS Bank

Target Price & Ratings History



Note *: Share price and Target price are adjusted for corporate actions.*

S.No.	Date	Closing Price	Target Price	Rating
1:	21 Jan 15	1.00	1.05	BUY
2:	10 Apr 15	1.03	1.10	BUY
3:	29 May 15	1.05	1.12	BUY
4:	22 Jul 15	1.07	1.14	BUY

Source: DBS Bank

DBS Bank recommendations are based 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 catalysts within this time frame)

Share price appreciation + dividends

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