

# Singapore Company Focus

## Keppel DC REIT

Bloomberg: KDCREIT SP | Reuters: KEPE.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

29 Oct 2015

### BUY

Last Traded Price: S\$1.06 STI : 3,040.51  
Price Target : S\$1.14 (8% upside)

Reason for Report : Company update

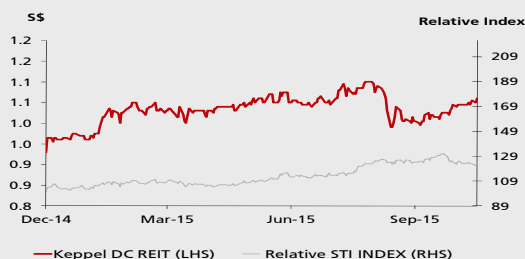
Potential Catalyst: Acquisitions

Where we differ: We have priced in acquisitions in our estimates

#### Analyst

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#### Price Relative



#### Forecasts and Valuation

FY Dec (\$ 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)	19.6	16.6	14.1	14.8
Distribution Yield (%)	5.1	6.0	6.4	6.8
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 (%)	-	-	-
Consensus DPU (S cts)	6.8	7.0	7.3
Other Broker Recs:	B: 5	S: 0	H: 1

ICB Industry : Financials

ICB Sector: Real Estate Investment Trusts

Principal Business: Keppel DC REIT is the first data center EIT to be listed in Asia and on the SGX. KDC REIT invests in a diversified portfolio of income-producing real estate assets which are primarily for data center purposes.

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

### A sweet first deal in Germany

- Target acquisition is in a key data centre hub with high barriers of entry near Frankfurt
- Accretive deal with many positives
- BUY maintained, TP S\$1.14

**A sweet first deal in Germany.** Keppel DC REIT announced the signing of a forward sale and purchase agreement with mainCubes One Immobilien GmbH & Co. KG (vendor) to acquire a data centre (maincubes DC) that will be fitted out to Tier III specifications, which is expected to complete in 2018. The purchase consideration is EUR84m (\$\$130m), 2.5% discount to valuation. The REIT will pay an initial deposit of 10% of the price upon contract signing, with the remainder upon completion. Post completion, mainCubes DC will be leased back on a 15-year triple-net lease with annual rental escalations, offering strong income visibility to the REIT.

**Key data centre market with high barriers of entry.** Maincubes DC will be located within the Offenbach am Main data centre hub, which is about 10km away from Frankfurt, Germany. This deal will represent Keppel DC REIT's first foray into Frankfurt's data centre market, which we understand should see healthy utilisation rates of c.80% on the back of accelerating demand for co-location space by end users, supported by excellent infrastructure already in place.

**Accretive acquisition with minimal downside risks.** We see many positives in this acquisition with (i) an attractive initial yield of 7.15% which will be immediately accretive to distributions, (ii) substantially de-risking any development risk to the vendor during construction period of which Keppel DC REIT will receive 7.15% coupon in return during the period, (iii) an increase in portfolio WALE from 8.9 to 10.0 years, offering increased income visibility. Gearing is estimated to increase to c.31% after payment of the 10% deposit.

**BUY, S\$1.14 TP maintained.** DPU is estimate to rise 2.7% on a proforma basis. Keppel DC REIT continues to utilise its under-g geared balance sheet and deliver on the acquisition front and we see more earnings upside in the medium term upon the expected acquisition of its data centre in SG from its sponsor. Maintain BUY.

#### At A Glance

Issued Capital (m shrs)	883
Mkt. Cap (\$m/US\$m)	936 / 667
Major Shareholders	
Keppel Telecom & Transport (%)	30.1
Wellington Management (%)	7.3
DBS Bank (%)	5.5
Free Float (%)	57.1
3m Avg. Daily Val (US\$m)	1.3

## INVESTMENT THESIS

Profile	Rationale
<p>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.</p>	<p><b>Riding on the global data boom.</b> Keppel DC REIT offers investors a unique exposure to 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 the 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%.</p> <p><b>Visible earnings growth profile underpinned by acquisition potential.</b> 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 &gt;S\$250m is expected to trigger an equity fundraising 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%</p> <p><b>Imputed S\$250m of acquisitions into FY16 numbers.</b> We have assumed S\$250m of acquisitions in FY16 to account for the purchase of T27; we have also assumed that the equity fundraising will bring gearing down to 30%, which is the Manager's long-term target level.</p>
Valuation	Risks
<p>We currently have a BUY recommendation, with a DCF-backed TP of S\$1.14. The stock offers an attractive yield of 6.8% for FY16 and upside will hinge on better-than-expected returns from acquisitions, or higher occupancies at co-location properties.</p>	<p><b>Higher maintenance capex relative to other asset classes.</b> 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.</p> <p><b>Competition from larger third-party data centre players.</b> 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.</p>

Source: DBS Bank

**Target acquisition details**



Artist impression of mainCubes DC, Offenbach am Main, Germany

<b>Location</b>	Offenbach am Main, Germany
<b>Land Tenure</b>	Freehold
<b>Land Area</b>	5,596 sqm
<b>Estimated lettable area</b>	11,780 sqm
<b>Vendor</b>	mainCubes One Immobilien GmbH & Co. KG
<b>Tenant</b>	mainCubes One GmbH

Source: company. DBS Bank

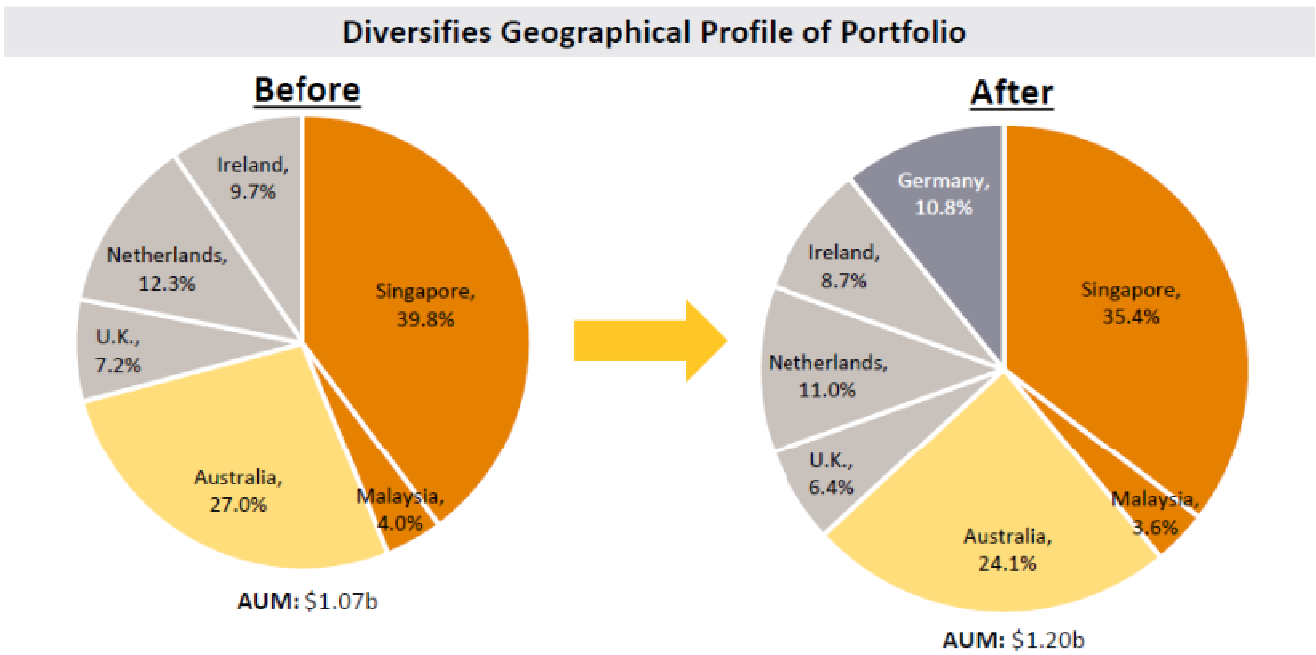
**Target acquisition details**



- **Strategic location:** mainCubes will be located within data centre hub that spans across Frankfurt and Offenbach
- **Proximity to internet exchange point (IXP):** mainCubes will be located approximately 800m (linear distance) from the world's leading IXP, DE-CIX
- **Minimal latency issues:** attractive location enables end-users to benefit from minimal latency, which is ideal for financial institutions and e-commerce related corporations

Source: Company. DBS Bank

**Geographical mix**



Source: Company. DBS Bank

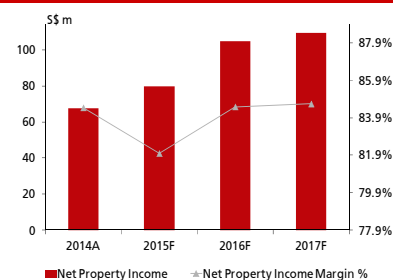
Source: company. DBS Bank

### Income Statement (\$\$ m)

FY Dec	2014A	2015F	2016F	2017F
Gross revenue	80	97	124	129
Property expenses	(12)	(18)	(19)	(20)
<b>Net Property Income</b>	<b>67</b>	<b>80</b>	<b>105</b>	<b>109</b>
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
<b>Net Income</b>	<b>50</b>	<b>59</b>	<b>80</b>	<b>84</b>
Tax	(3)	(3)	(4)	(5)
Minority Interest	0	0	0	0
Preference Dividend	0	0	0	0
<b>Net Income After Tax</b>	<b>48</b>	<b>56</b>	<b>75</b>	<b>79</b>
Total Return	48	56	75	79
Non-tax deductible Items	0	0	0	0
Net Inc available for Dist.	48	57	75	80
<b>Growth &amp; Ratio</b>				
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

### Net Property Income and Margins



## Keppel DC REIT

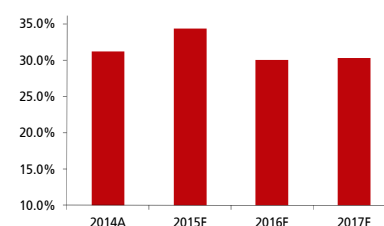
## Quarterly / Interim Income Statement (\$\$ m)

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
<b>Net Income</b>	<b>19</b>	<b>17</b>	<b>18</b>
Tax	(1)	(1)	(1)
Minority Interest	0	0	0
<b>Net Income after Tax</b>	<b>17</b>	<b>15</b>	<b>17</b>
Total Return	17	15	17
Non-tax deductible Items	0	(1)	(2)
Net Inc available for Dist.	17	14	14
<b>Growth &amp; Ratio</b>			
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

## Balance Sheet (\$\$ 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 Invt	26	32	26	25
Inventory	0	0	0	0
Debtors	47	32	41	43
Other Current Assets	0	0	0	0
<b>Total Assets</b>	<b>1,122</b>	<b>1,164</b>	<b>1,421</b>	<b>1,426</b>
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
<b>Total Funds &amp; Liabilities</b>	<b>1,122</b>	<b>1,164</b>	<b>1,421</b>	<b>1,426</b>
Non-Cash Wkg. Capital	29	23	29	30
Net Cash/(Debt)	(301)	(345)	(380)	(386)
<b>Ratio</b>				
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

## Aggregate Leverage



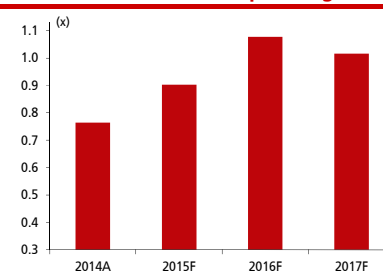
Source: Company, DBS Bank

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

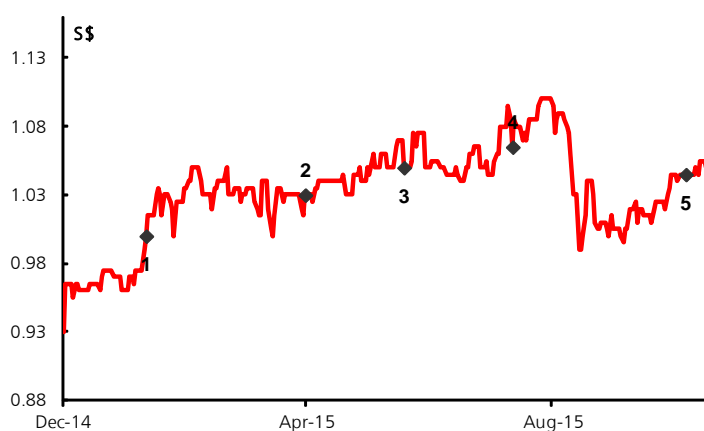
FY Dec	2014A	2015F	2016F	2017F
Pre-Tax Income	50	59	80	84
Dep. & Amort.	0	0	0	0
Tax Paid	0	0	(3)	(4)
Associates & JV Inc/(Loss)	0	0	0	0
Chg in Wkg.Cap.	0	3	(7)	(1)
Other Operating CF	(16)	0	0	0
<b>Net Operating CF</b>	<b>34</b>	<b>63</b>	<b>70</b>	<b>78</b>
Net Invnt in Properties	(430)	(50)	(254)	(5)
Other Invnts (net)	(1)	0	0	0
Invnts in Assoc. & JV	0	0	0	0
Div from Assoc. & JVs	0	0	0	0
Other Investing CF	(44)	0	0	0
<b>Net Investing CF</b>	<b>(475)</b>	<b>(50)</b>	<b>(254)</b>	<b>(5)</b>
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
<b>Net Financing CF</b>	<b>449</b>	<b>(6)</b>	<b>179</b>	<b>(75)</b>
Currency Adjustments	0	0	0	0
Chg in Cash	8	6	(5)	(1)
Operating CFPS (\$ cts)	3.9	6.7	7.7	7.2
Free CFPS (\$ cts)	(44.8)	1.4	(18.5)	6.7

Source: Company, DBS Bank

### Distribution Paid / Net Operating CF



### Target Price & Ratings History



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

Source: DBS Bank

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 catalysts within this time frame)

*Share price appreciation + dividends*

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