

# Keppel REIT (KREIT SP)

Property - REITS

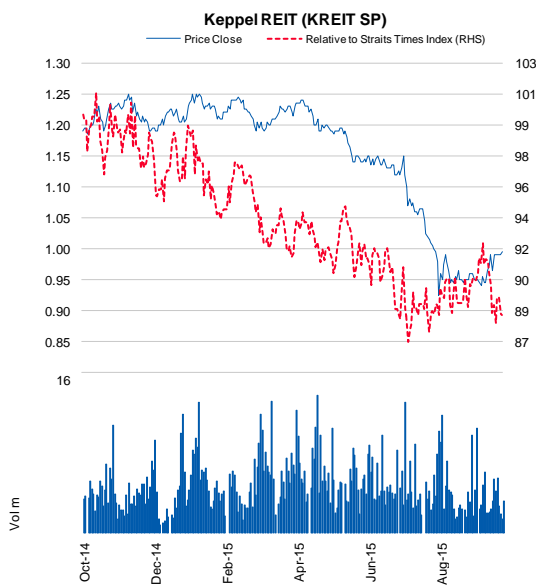
Market Cap: USD2,303m

**Sell** (Maintained)

 Target Price: **SGD0.86**

 Price: **SGD1.00**

## Occupancy Rates Decline

 Macro   
 Risks   
 Growth   
 Value 


Source: Bloomberg

Avg Turnover (SGD/USD)	4.28m/3.07m
Cons. Upside (%)	27.0
Upside (%)	-14.0
52-wk Price low/high (SGD)	0.93 - 1.25
Free float (%)	58
Share outstanding (m)	3,200
<b>Shareholders (%)</b>	
Keppel Land	42.2
Bank of New York Mellon	3.4
DBS Group Holdings	1.2

### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(18.5)	4.7	(11.2)	(19.1)	(15.3)
Relative	(8.5)	(0.9)	(1.6)	(4.9)	(11.4)

**Ivan Looi** +65 6232 3841

[ivan.looi@rhbgroup.com](mailto:ivan.looi@rhbgroup.com)
**Ong Kian Lin** +65 6232 3896

[ong.kian.lin@rhbgroup.com](mailto:ong.kian.lin@rhbgroup.com)

**Keppel REIT's 9M15 DPU met ~73% of our full-year estimate, at 10.5% lower than the year before. Maintain SELL, with a TP of SGD0.86 (14% downside). Its overall portfolio occupancy rate dipped to 98.5%, mainly due to the closure of SCB's equity business in MBFC Tower 1. We kept our SELL rating, as Keppel REIT is still one of the highest-g geared REITs within the sector (42.6%), while it grapples with headwinds in the office rental market.**

- ◆ **3Q15/9M15 DPU declines 8.1/10.5% YoY.** Keppel REIT's 9M15 results were in line with our expectation as 9M15 distribution per unit (DPU) declined 10.5% YoY, meeting ~73% of our full-year estimate. The REIT achieved an average 16% positive rental reversion for 9M15 (1H15: 18%). The decline in DPU was mainly attributable to the divestment of Prudential Tower on 26 Sep 2014.
- ◆ **Occupancy dropped mainly due to closure of Standard Chartered Bank's (SCB) equity business.** Recall that SCB announced that it was shutting down its equities business in January. The bank returned the space in Marina Bay Financial Centre (MBFC) Tower 1 to the REIT in the last quarter, which caused its portfolio occupancy rate to dip to 98.5% from 99.3%. We learnt from management that there will not be any further decline in occupancy rates relating to the closure of SCB's equity business.
- ◆ **Impacted by the weakening AUD.** The REIT's Australian assets with direct rentals registered a negative 9M15 revenue YoY growth of 7.7-8.2% following the weakening of the AUD. Keppel REIT stated that it has hedged almost 100% distributable income from Australia for the remainder of 2015. Its sensitivity analysis stated that its NAV would drop by 2 cents and gearing could rise by 0.3%, should AUD1.00 trade at SGD0.95 (currently AUD1.00 = SGD1.01).
- ◆ **Maintain SELL.** Since we expect further headwinds in the office rental market in the coming years, we remain cautious as 28.4% of its portfolio NLA faces lease expiries in the next two years. We reiterate our SELL recommendation, while our DDM-based SGD0.86 TP remains unchanged.

Forecasts and Valuations	Dec-13	Dec-14	Dec-15F	Dec-16F	Dec-17F
Total turnover (SGDm)	174	184	179	195	206
Net property income (SGDm)	312	336	215	235	248
Reported net profit (SGDm)	726	567	246	274	285
Total distributable income (SGDm)	214	206	248	230	237
DPS (SGD)	0.08	0.07	0.08	0.07	0.07
DPS growth (%)	1.4	(8.2)	7.3	(8.0)	2.3
Recurring P/E (x)	3.7	5.2	12.9	11.6	11.3
P/B (x)	0.71	0.71	0.75	0.76	0.77
Dividend Yield (%)	7.9	7.3	7.8	7.2	7.3
Return on average equity (%)	19.7	13.6	5.7	6.5	6.8
Return on average assets (%)	11.2	8.0	3.3	3.5	3.6
Interest coverage ratio (x)	4.76	4.70	1.62	2.04	2.10

Source: Company data, RHB

Figure 1: Keppel REIT's 3Q15 results summary

(SGD m)	3Q14	2Q15	3Q15	% QoQ	% YoY	Comments
<b>Gross revenue</b>	<b>47.6</b>	<b>43.0</b>	<b>42.2</b>	<b>(1.8)</b>	<b>(11.4)</b>	Property income and net property income for 3Q15 were SGD42.2m and SGD33.4m respectively, compared to its property income and net property income of SGD47.6m and SGD38.5 m respectively for 3Q14. The variance was mainly attributable to the divestment of Prudential Tower on 26 Sep 2014. This was partially offset by higher property income and net property income from OFC and Bugis Junction Towers.
Operating expenses	(9.1)	(8.3)	(8.8)	6.5	(3.5)	
<b>NPI</b>	<b>38.5</b>	<b>34.7</b>	<b>33.4</b>	<b>(3.8)</b>	<b>(13.3)</b>	
Income support	12.7	4.8	4.8	(0.6)	(61.9)	This variance was mainly due to the divestment gain from hiving off Prudential Tower as well as higher fair value gain on investment Properties for 3Q14.
Other income	0.0	0.0	0.0	nm	nm	
Manager's fees	(11.5)	(12.4)	(12.5)	0.4	8.4	
Trustee fees	(3.1)	(1.4)	(2.3)	63.2	(26.3)	
Other expenses	(9.7)	(4.5)	(4.5)	(0.6)	(54.0)	
Net income before financing cost & tax	26.9	21.3	19.0	(10.6)	(29.3)	
Interest income	8.3	9.5	9.3	(2.9)	11.2	
Borrowing costs	(15.3)	(16.8)	(17.1)	1.9	11.5	
EBT	19.9	14.0	11.2	(20.3)	(43.8)	
Share of profit of associate company & JV	18.4	24.0	22.4	(6.6)	22.0	
Extraordinary items	11.3	1.0	1.0	2.4	(91.0)	
Revaluations of investment properties	92.3	0.0	20.9	nm	(77.4)	
Total return before tax	141.8	39.0	55.5	nm	(77.4)	
Tax	(3.5)	(1.8)	(4.5)	148.6	26.7	
Minority Interest	0.1	0.0	0.0	0.0	(71.9)	
Total return - reported	138.3	37.2	51.0	37.0	(63.1)	
Total return (ex exceptionals)	34.7	36.2	29.1	(19.6)	(16.1)	
Add-back: Non tax deductibles	(89.7)	15.8	(1.1)	nm	(98.8)	
<b>Income available for distribution</b>	<b>52.0</b>	<b>54.8</b>	<b>54.4</b>	<b>(0.8)</b>	<b>4.6</b>	
<b>Distribution to unitholders</b>	<b>52.0</b>	<b>54.8</b>	<b>54.4</b>	<b>(0.8)</b>	<b>4.6</b>	
Number of units (end of period) ('m)	3,002	3,187	3,200	0.4	6.6	
<b>DPU (SGD-cts)</b>	<b>1.85</b>	<b>1.72</b>	<b>1.70</b>	<b>(1.2)</b>	<b>(8.1)</b>	
<b>NAV (SGD)</b>	<b>1.40</b>	<b>1.40</b>	<b>1.39</b>	<b>(0.7)</b>	<b>(0.7)</b>	
Payout ratio (%)	100.0	100.0	100.0	0.0 ppt	0.0 ppt	
NPI margins (%)	80.9	80.8	79.2	(1.6) ppt	(1.7) ppt	

Source: RHB

Figure 2: Keppel REIT's 9M15 results summary

(SGD m)	9M14	9M15	% Change	RHB FY15F	% of FY15F	Comments
<b>Gross revenue</b>	<b>141.8</b>	<b>127.6</b>	<b>(10.0)</b>	<b>179.1</b>	<b>71.2</b>	Property income and net property income for YTD Sep 2015 were SGD127.6m and SGD102.7m respectively, compared to the property income and net property income of SGD141.8m and SGD117.2m respectively for YTD Sep 2014. The variance was attributable mainly to the divestment of Prudential Tower on 26 Sep 2014. This was partially offset by higher property income from OFC and Bugis Junction Towers and higher net property income from Bugis Junction Towers.
Operating expenses	(24.6)	(24.9)	1.2	(37.6)	66.2	
<b>NPI</b>	<b>117.2</b>	<b>102.7</b>	<b>(12.4)</b>	<b>141.6</b>	<b>72.5</b>	
Income support	37.9	15.8	(58.2)	40.2	39.4	
Other income	0.0	0.0	nm	0.0	nm	
Manager's fees	(34.3)	(37.2)	8.5	(43.0)	86.5	
Trustee fees	(5.3)	(6.1)	16.1	(2.3)	271.8	
Other expenses	(28.1)	(14.4)	(48.7)	(49.4)	29.2	
Net income before financing cost & tax	87.4	60.7	(30.5)	87.1	69.8	
Interest income	28.4	27.8	(2.3)	22.3	124.5	
Borrowing costs	(45.0)	(50.2)	11.4	(74.4)	67.4	The group's total returns before tax for YTD Sep 2015 was SGD132.9 m, compared to SGD224.7m for YTD Sep 2014. This variance was mainly due to the gain from divesting of Prudential Tower as well as higher fair value gain on investment properties for YTD Sep 2014.
EBT	70.8	38.4	(45.8)	34.9	109.8	
Share of profit of associate company & JV	50.4	70.8	40.7	144.4	49.1	
Extraordinary items	28.1	26.4	(6.0)	0.0	nm	
Revaluations of investment properties	92.3	20.9	(77.4)	0.0	nm	
Total return before tax	224.7	132.9	(77.4)	180.7	nm	
Tax	(9.0)	(8.2)	(8.8)	(6.8)	119.6	
Minority Interest	0.1	0.1	(47.1)	(0.1)	nm	
Total return - reported	215.7	124.8	(42.2)	173.8	71.8	
Total return (ex exceptionals)	95.4	77.5	(18.8)	173.8	44.6	
Add-back: Non tax deductibles	(64.2)	30.3	nm	67.4	45.1	
<b>Income available for distribution</b>	<b>160.4</b>	<b>163.2</b>	<b>1.8</b>	<b>247.9</b>	<b>65.8</b>	
<b>Distribution to unitholders</b>	<b>160.4</b>	<b>163.2</b>	<b>1.8</b>	<b>247.9</b>	<b>65.8</b>	
Number of units (end of period) ('m)	3,002	3,200	6.6	3,195	100.2	
<b>DPU (SGD-cts)</b>	<b>5.72</b>	<b>5.12</b>	<b>(10.5)</b>	<b>7.00</b>	<b>73.1</b>	
<b>NAV (SGD)</b>	<b>1.40</b>	<b>1.39</b>	<b>(0.7)</b>	<b>1.33</b>	<b>104.8</b>	
Payout ratio (%)	100.0	100.0	0.0 ppt	100.0		
NPI margins (%)	82.7	80.5	(2.2) ppt	79.0		

Source: RHB

**Figure 3: Key performance metrics**

<b>Operating Performance:</b>	<b>3Q14</b>	<b>4Q14</b>	<b>1Q15</b>	<b>2Q15</b>	<b>3Q15</b>
Portfolio Occupancy: (%)	99.3	99.3	99.3	99.3	98.5
Rental Reversion: (%)	32.3	17.0	19.0	18.0	16.0
DPU (SG cts)	1.85	1.51	1.70	1.72	1.70
	<b>FY-1</b>	<b>FY-2</b>	<b>FY-3</b>	<b>FY-4</b>	<b>≥FY-5</b>
Lease Expiry Profile: (NLA %)	0.6	16.3	12.1	7.7	18.3
Rent Review Profile: (NLA %)	0.0	4.5	3.8	14.7	1.5
<b>Capital Management:</b>	<b>3Q14</b>	<b>4Q14</b>	<b>1Q15</b>	<b>2Q15</b>	<b>3Q15</b>
All-in cost of borrowing: (%)	2.20	2.23	2.47	2.50	2.50
Aggreg. Leverage: (%)	42.1	43.3	42.4	42.6	42.6
Term of Debt: (yrs)	3.5	3.6	3.4	3.9	3.6

Source: Company data

**Figure 4: Keppel REIT's DDM valuation**

<b>DDM</b>	<b>FY15F</b>	<b>FY16F</b>	<b>FY17F</b>	<b>FY18F</b>	<b>Terminal Value</b>
DPU (SGD cts)	7.00	6.94	7.11	6.98	82.86
<b>Fair value (SGD)</b>	<b>0.86</b>				
Current price (SGD)	1.00				
Price upside (%)	-14.0%				
Distribution yield (%)	7.0%				
<b>Assumptions</b>					
Risk-free rate (%)	<b>3.0</b>				
Beta	<b>0.8</b>				
Cost of equity (%)	<b>7.3</b>				

Source: RHB, Bloomberg, Company data

## Financial Exhibits

<b>Profit &amp; Loss (SGDm)</b>	<b>Dec-13</b>	<b>Dec-14</b>	<b>Dec-15F</b>	<b>Dec-16F</b>	<b>Dec-17F</b>
Total turnover	174	184	179	195	206
Property operating expenses	138	151	36	40	42
<b>Net property income</b>	<b>312</b>	<b>336</b>	<b>215</b>	<b>235</b>	<b>248</b>
Management fees	(43)	(45)	(43)	(43)	(44)
Trust expenses	(7)	(7)	(52)	(12)	(12)
<b>Operating EBIT</b>	<b>263</b>	<b>283</b>	<b>121</b>	<b>180</b>	<b>192</b>
Depreciation of fixed assets	(45)	(37)	(126)	(99)	(104)
Amortisation of intangible assets	12	-	-	-	-
Operating EBITDA	295	320	246	279	296
Net income from investments	451	273	144	149	154
Other recurring income	30	34	33	11	9
Interest income	37	37	22	23	22
Interest expense	(55)	(60)	(74)	(88)	(92)
<b>Pre-tax profit</b>	<b>726</b>	<b>567</b>	<b>246</b>	<b>274</b>	<b>285</b>
<b>Profit after tax &amp; minorities</b>	<b>726</b>	<b>567</b>	<b>246</b>	<b>274</b>	<b>285</b>
<b>Reported net profit</b>	<b>726</b>	<b>567</b>	<b>246</b>	<b>274</b>	<b>285</b>
Adjustment for distributable income	(512)	(360)	2	(44)	(48)
<b>Total distributable income</b>	<b>214</b>	<b>206</b>	<b>248</b>	<b>230</b>	<b>237</b>

Source: Company data, RHB

<b>Cash flow (SGDm)</b>	<b>Dec-13</b>	<b>Dec-14</b>	<b>Dec-15F</b>	<b>Dec-16F</b>	<b>Dec-17F</b>
<b>Operating profit</b>	<b>263</b>	<b>283</b>	<b>121</b>	<b>180</b>	<b>192</b>
<b>Depreciation &amp; amortisation</b>	<b>32</b>	<b>37</b>	<b>126</b>	<b>99</b>	<b>104</b>
<b>Change in working capital</b>	<b>15</b>	<b>(30)</b>	<b>(3)</b>	<b>9</b>	<b>6</b>
Other operating cash flow	(262)	(246)	(91)	(134)	(144)
<b>Operating cash flow</b>	<b>48</b>	<b>44</b>	<b>152</b>	<b>154</b>	<b>157</b>
<b>Cash flow from operations</b>	<b>48</b>	<b>44</b>	<b>152</b>	<b>154</b>	<b>157</b>
Capex	(18)	(2)	(14)	(15)	(15)
Other new investments	(187)	-	(106)	(53)	(53)
Other investing cash flow	(19)	84	207	185	187
<b>Cash flow from investing activities</b>	<b>(224)</b>	<b>82</b>	<b>87</b>	<b>117</b>	<b>119</b>
Dividends paid	(211)	(215)	(233)	(239)	(233)
Increase in debt	261	(10)	120	68	68
Other financing cash flow	115	167	(74)	(88)	(92)
<b>Cash flow from financing activities</b>	<b>165</b>	<b>(57)</b>	<b>(187)</b>	<b>(259)</b>	<b>(257)</b>
Cash at beginning of period	102	91	200	63	55
<b>Total cash generated</b>	<b>(11)</b>	<b>68</b>	<b>52</b>	<b>12</b>	<b>19</b>
<b>Implied cash at end of period</b>	<b>91</b>	<b>159</b>	<b>251</b>	<b>75</b>	<b>74</b>

Source: Company data, RHB

## Financial Exhibits

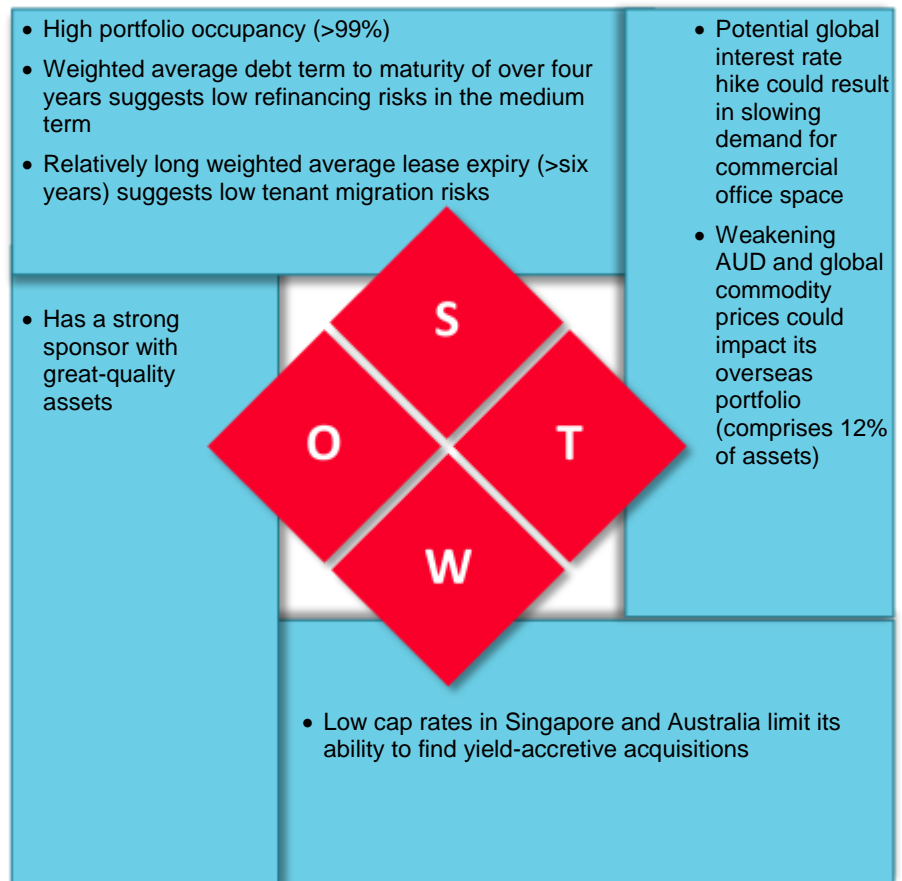
<b>Balance Sheet (SGDm)</b>	<b>Dec-13</b>	<b>Dec-14</b>	<b>Dec-15F</b>	<b>Dec-16F</b>	<b>Dec-17F</b>
Total cash and equivalents	91	200	63	55	56
Accounts receivable	34	25	35	38	40
Other current assets	1	1	1	1	1
<b>Total current assets</b>	<b>126</b>	<b>225</b>	<b>100</b>	<b>95</b>	<b>97</b>
Total investments	6,650	7,104	7,640	7,707	7,775
Total non-current assets	6,650	7,104	7,640	7,707	7,775
<b>Total assets</b>	<b>6,775</b>	<b>7,329</b>	<b>7,739</b>	<b>7,802</b>	<b>7,872</b>
Short-term debt	282	275	403	654	715
Accounts payable	94	84	99	108	114
Other current liabilities	23	21	15	16	17
<b>Total current liabilities</b>	<b>399</b>	<b>380</b>	<b>517</b>	<b>778</b>	<b>846</b>
Total long-term debt	2,401	2,390	2,908	2,725	2,732
Other liabilities	76	99	76	80	83
<b>Total non-current liabilities</b>	<b>2,477</b>	<b>2,489</b>	<b>2,984</b>	<b>2,805</b>	<b>2,815</b>
<b>Total liabilities</b>	<b>2,877</b>	<b>2,870</b>	<b>3,502</b>	<b>3,584</b>	<b>3,661</b>
Share capital	3,897	4,457	4,235	4,216	4,209
<b>Shareholders' equity</b>	<b>3,897</b>	<b>4,457</b>	<b>4,235</b>	<b>4,216</b>	<b>4,209</b>
Minority interests	2	2	2	2	2
Other equity	(0)	(0)	0	(0)	(0)
<b>Total equity</b>	<b>3,899</b>	<b>4,459</b>	<b>4,237</b>	<b>4,218</b>	<b>4,211</b>
<b>Total liabilities &amp; equity</b>	<b>6,775</b>	<b>7,329</b>	<b>7,739</b>	<b>7,802</b>	<b>7,872</b>

Source: Company data, RHB

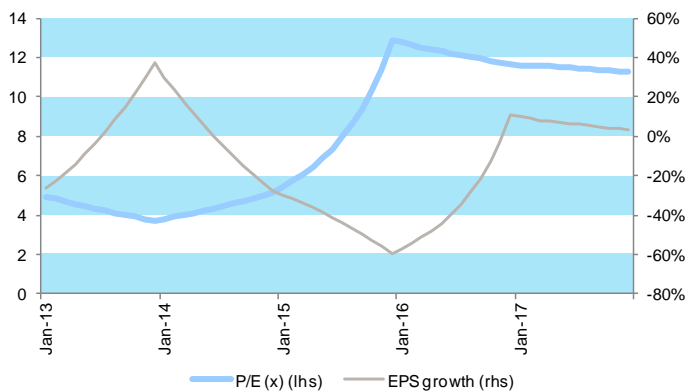
<b>Key Ratios (SGD)</b>	<b>Dec-13</b>	<b>Dec-14</b>	<b>Dec-15F</b>	<b>Dec-16F</b>	<b>Dec-17F</b>
Revenue growth (%)	10.9	5.8	(2.7)	9.1	5.6
Net profit growth (%)	43.8	(21.9)	(56.5)	11.4	4.0
EPS growth (%)	37.2	(28.0)	(59.8)	10.5	3.2
BVPS growth (%)	6.2	0.6	(5.7)	(1.2)	(0.9)
Net profit margin (%)	417.0	307.8	137.5	140.3	138.3
Return on average assets (%)	11.2	8.0	3.3	3.5	3.6
Return on average equity (%)	19.7	13.6	5.7	6.5	6.8
Net debt to equity (%)	66.5	55.3	76.7	78.8	80.5
DPS	0.08	0.07	0.08	0.07	0.07
Recurrent cash flow per share	0.02	0.01	0.05	0.05	0.05

Source: Company data, RHB

## SWOT Analysis

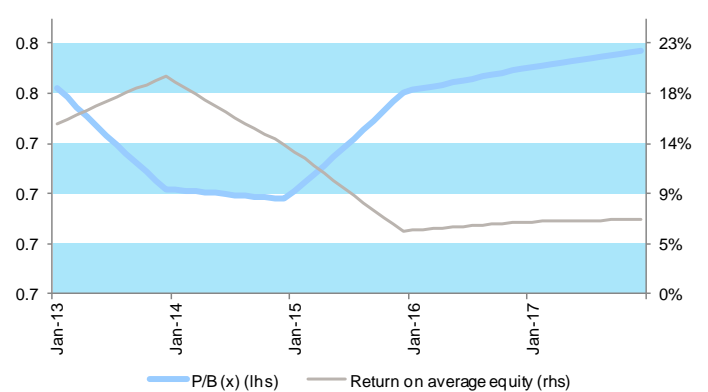


P/E (x) vs EPS growth



Source: Company data, RHB

P/BV (x) vs ROAE



Source: Company data, RHB

## Company Profile

Keppel REIT is a real estate investment trust listed on the Singapore Exchange. Sponsored by Keppel Land, the trust owns and invests in a portfolio of income-producing commercial real estate and real estate related-assets in Singapore and across Asia

## Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2015-09-01	Sell	0.86	0.97
2015-07-21	Neutral	1.13	1.12
2015-04-14	Neutral	1.18	1.23
2014-10-16	Neutral	1.18	1.18
2014-01-21	Buy	1.66	1.16
2013-10-16	Buy	1.66	1.25
2013-08-20	Buy	1.50	1.17

Source : RHB, Bloomberg



## RHB Guide to Investment Ratings

**Buy:** Share price may exceed 10% over the next 12 months

**Trading Buy:** Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain

**Neutral:** Share price may fall within the range of +/- 10% over the next 12 months

**Take Profit:** Target price has been attained. Look to accumulate at lower levels

**Sell:** Share price may fall by more than 10% over the next 12 months

**Not Rated:** Stock is not within regular research coverage

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**Kuala Lumpur**

**RHB Research Institute Sdn Bhd**  
Level 11, Tower One, RHB Centre  
Jalan Tun Razak  
Kuala Lumpur  
Malaysia  
Tel : +(60) 3 9280 2185  
Fax : +(60) 3 9284 8693

**Hong Kong**

**RHB OSK Securities Hong Kong Ltd.**  
12<sup>th</sup> Floor  
World-Wide House  
19 Des Voeux Road  
Central, Hong Kong  
Tel : +(852) 2525 1118  
Fax : +(852) 2810 0908

**Singapore**

**RHB Research Institute Singapore  
Pte Ltd (formerly known as DMG & Partners Research  
Pte Ltd)**  
10 Collyer Quay  
#09-08 Ocean Financial Centre  
Singapore 049315  
Tel : +(65) 6533 1818  
Fax : +(65) 6532 6211

**Jakarta**

**PT RHB OSK Securities Indonesia**  
Wisma Mulia, 20th Floor  
Jl. Jend. Gatot Subroto No. 42  
Jakarta 12710, Indonesia  
Tel : +(6221) 2783 0888  
Fax : +(6221) 2783 0777

**Shanghai**

**RHB OSK (China) Investment Advisory Co. Ltd.**  
Suite 4005, CITIC Square  
1168 Nanjing West Road  
Shanghai 20041  
China  
Tel : +(8621) 6288 9611  
Fax : +(8621) 6288 9633

**Phnom Penh**

**RHB OSK Indochina Securities Limited**  
No. 1-3, Street 271  
Sangkat Toeuk Thla, Khan Sen Sok  
Phnom Penh  
Cambodia  
Tel: +(855) 23 969 161  
Fax: +(855) 23 969 171

**Bangkok**

**RHB OSK Securities (Thailand) PCL**  
10th Floor, Sathorn Square Office Tower  
98, North Sathorn Road, Silom  
Bangrak, Bangkok 10500  
Thailand  
Tel: +(66) 2 862 9999  
Fax : +(66) 2 862 9799