

Korea Real Estate Investment Trust (034830)

BUY (Maintain), TP W5,600 (Maintain)

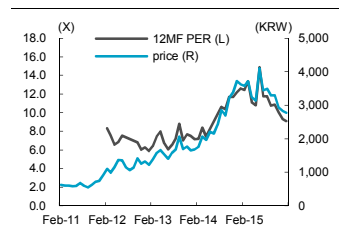
Stock price (Jan 7, KRW)	2,780	Yr to	Sales	OP	NP	EPS	% chg	EBITDA	PE	EV/EBITDA	PB	ROE	DY
Market cap (USD mn)	585	Dec	(W bn)	(W bn)	(W bn)	(KRW)	(YoY)	(W bn)	(x)	(x)	(x)	(%)	(%)
Shares outstanding (mn)	252	2013A	166	68	52	205	8.9	68	8.0	7.4	1.1	14.7	1.8
52W High/Low (KRW)	4,370/2,640	2014A	143	81	60	237	15.7	81	15.7	11.7	2.2	14.8	1.1
6M avg. daily turnover (USD mn)	4.2	2015F	142	92	70	277	16.9	93	10.2	7.5	1.4	15.0	1.4
Free float (%)	59.5	2016F	165	104	79	315	13.6	105	8.8	6.5	1.2	14.7	1.6
Foreign ownership (%)	4.2	2017F	184	122	93	368	17.1	123	7.6	5.5	1.0	14.8	1.8
Major shareholders (%)													
Leading Value Fund II and 2 others	37.6												
NPS	9.2												

Opening new market with top financial capacity

Performance

	1M	6M	12M
Absolute (%)	(3.5)	(28.4)	(28.1)
Rel. to Kospi (%p)	(0.5)	(21.7)	(29.2)

12MF PE trend



Top in terms of financial capacity: The biggest merit of Korea Real Estate Investment Trust (KOREIT), the top-performing real estate trust player, is its strong financial capacity. Korea Ratings recently lifted KOREIT's long-term credit rating from A- (positive) to A (stable) and also revised its short-term credit rating from A2- to A2. These credit ratings reflect KOREIT's firm position in the real estate trust market and that the disposal of distressed business sites should boost profit generation.

KOREIT's financial ratio is fast improving. Trust companies are required to maintain their NCR (net operating capital/total risk (market risk + credit risk + operating risk)) at 150% or above, but KOREIT's NCR is 1,139%. The debt ratio that reached 45% in 2013 has continued to drop and registered 14% in 3Q15. Cash equivalents as of 3Q15 reach ~W100bn, including W12.3bn in cash, W17bn in deposits and W80bn in financial assets (ELB, ABCP and others), while its only debt is W20bn in corporate bonds, which means that actual net cash is ~W80bn. (Given the trust business' accounting standards, some financial assets are not categorized as cash equivalents.) KOREIT's solid financial capacity is proving to be a driving force for gaining a bigger market share amid increasingly stringent housing supply conditions such as interim payments and project financing loan requirements.

Profitability indicators also rank high: KOREIT's strength is in leveraged trusts that make a 65% contribution to fee income. The per project fees for leveraged trusts hit an average of W1.9bn in 2011 and has steadily risen to reach W2.86bn in 1Q15. The average fee per project for management land trusts is a somewhat less W250mn. With a heavy weighting of leveraged trusts, KOREIT's net profit margin surpassed 50% every quarter in 2015 and touched as high as 63.3% in 3Q15. KOREIT's development trust fees are calculated at 2.48%, which is much more than the average 0.55% of the 11 real estate trust companies. As such, OP grew 13.9% YoY in 2015 and will likely increase 13.6% in 2016. We estimate 2015 NPM at 49.2% and it should stay at a high level of 48% in 2016.

Profit diversification: KOREIT's operations had centered on the leveraged trust business that comprises mainly regular presales. But since 2015, the company has been trying to diversify its revenue streams by focusing on reconstruction and developing products related to real estate investment trust (REIT) and New Stay (corporate-managed rental housing). At end-December 2015, KOREIT said it would adopt the New Stay model to the stagnant Incheon-Cheongcheon #2 redevelopment project. Specifically, KOREIT agreed to purchase 3,500 general presale units (total volume 5,190 units) and convert them into New Stays. Accordingly, KOREIT through its special purpose company will play the role of an asset management firm for the New Stay business and collect rental income after construction is completed in 2019.

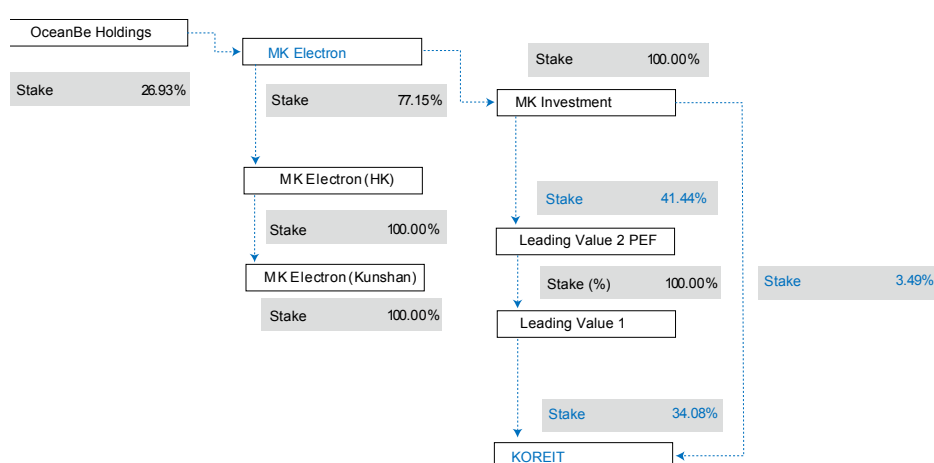
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[Reference] KOREIT major shareholders: KOREIT's largest shareholder is Leading Value Fund I that is invested by MK Electron (MKE). MKE controls 37.5% of KOREIT via Leading Value Fund I (34.08%) and its subsidiary MK Investment (3.49%). MK Investment controls Leading Value Fund II while Leading Value Fund II owns a stake in KOREIT via Leading Value Fund I. In 2013, MKE established the wholly-owned subsidiary MK Investment and became a general partner of Leading Value Fund II by acquiring a 41.4% stake. According to news reports, MKE's actual ownership of KOREIT excluding other limited partners was below the 20% level at 17.6%. But in October 2015, MKE paid W26.4bn for a 100% stake in T&K Investment, a limited partner that has an investment in Leading Value Fund II, and this lifted KOREIT's actual ownership from 17.6% to 28%.

After finding a new owner with MKE gaining managerial control in 2015, KOREIT continues to use its operating skills and deliver solid earnings, further strengthening its presence in the leveraged trust market. We believe results from new operations such as redevelopment projects will materialize from March when trust companies are allowed to advance on the renewal business thanks to implementation of the Urban Improvement Act.

Figure 26. KOREIT governance structure



Source: Company data, Korea Investment & Securities

Table 15. Real estate trust market AUM and fee comparisons (2014)

(W bn, %)

Category		Real estate trust company average			KOREIT		
		AUM (W tn)	Fee	Fee rate	AUM	Fee	Fee rate
Land development trust	Leveraged-type land trust	3.0	172.6	0.55	465	27.5	0.39
	Management-type land trust	28.2			6,590		
Non-land development trust	Collateral trust	79.9	60.8	0.08	4,953	4.4	0.09
	Management trust	3.0	2.1	0.07	288	0.3	0.1
	Disposal trust	6.3	5.1	0.08	687	0.6	0.09
	Presale management trust	4.9	18.7	0.38	1,299	4.9	0.38
Total		125.3	289.3	0.21	14,283.6	37.6	0.26

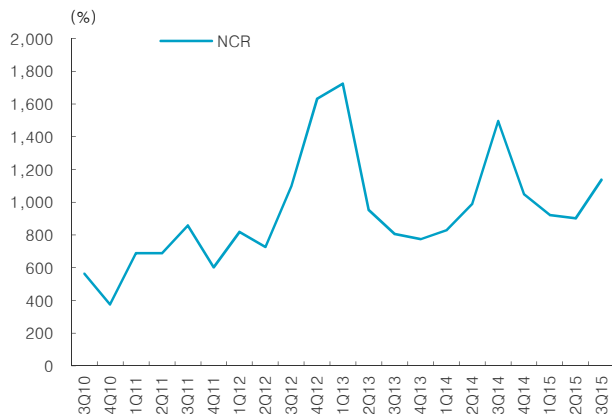
Source: Company data, Financial Supervisory Service

Table 16. Average fee per order in real estate trust market

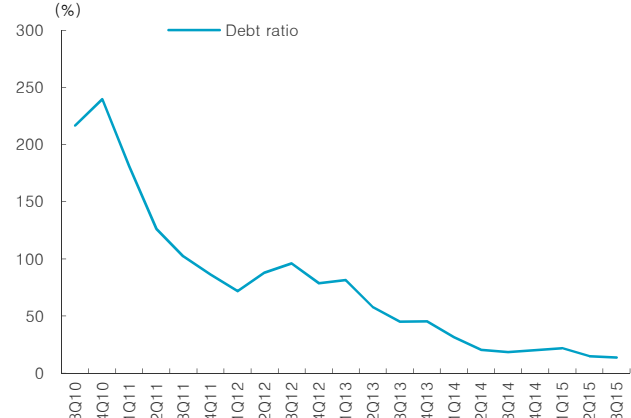
(W bn)

	Category	2011	2012	2013	2014	1Q15
Land development trust	Leveraged-type land trust	1.90	2.27	0.20	2.27	2.86
	Management-type land trust	0.28	0.27	0.10	0.27	0.25
Non-land development trust	Collateral trust	0.02	0.01	0.01	0.01	0.01
	Management trust	0.01	0.01	0.01	0.02	0.03
	Disposal trust	0.02	0.02	0.04	0.02	0.03
	Presale management trust	0.11	0.10	0.07	0.09	0.10

Source: Korea Investment & Securities

Figure 27. KOREIT NCR change


Source: Company data,

Figure 28. KOREIT debt ratio change


Source: Company data

Table 17. KOREIT earnings estimates

(W bn)

		1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15F	2014	2015F	2016F	2017F
Sales	Total	36	43	30	34	32	37	34	39	143	142	165	184
	1. Fees	16	16	18	19	12.6	22.3	23.0	28.2	70	86	96	108
	Leveraged	15	16	18	19	12.2	21.7	22.3	27.8	68	84	94	106
	Non-leveraged	0	1	0	0	0.4	0.6	0.7	0.4	2	2	2	2
	2. REITs	2	3	3	3	9.1	5.0	2.0	0.9	11	17	15	15
3. Interest income		18	16	10	9	8.5	8.4	6.1	7.0	53	30	44	49
	4. Other	0	7	(0)	3	1	1	3	3	10	9	10	12
OP		19	21	25	16	21	25	28	17	81	92	104	122
YoY		-19.7%	-9.1%	281.5%	12.9%	7.2%	19.3%	15.5%	9.0%	19.4%	13.9%	13.6%	17.1%
OPM		53.5%	49.3%	81.9%	45.8%	65.6%	68.2%	83.3%	44.6%	56.4%	64.8%	63.2%	66.4%
EBT		19	21	25	15	21	25	28	14	80	92	104	122
NP		15	16	19	10	16	20	22	10	60	70	79	93
YoY (%)		-20.2%	-8.3%	278.7%	-4.6%	7.9%	20.8%	15.5%	-2.9%	15.7%	16.7%	13.6%	17.1%

Source: Company data, Korea Investment & Securities

Balance sheet

FY-ending Dec. (W bn)	2013A	2014A	2015F	2016F	2017F
Financial institution assets	413	383	294	294	294
Current assets	64	78	65	71	76
Cash & cash equivalents	41	32	50	55	60
Other current assets	23	46	15	16	16
Non-current assets	80	57	202	275	363
Investment assets	25	13	27	28	29
Tangible assets	0	1	0	0	0
Others	55	43	175	247	334
Total Assets	556	517	560	640	733
Current liabilities	37	42	25	25	25
Short-term borrowings	0	0	0	0	0
Current portion of debt	0	0	0	0	0
Others	37	42	25	25	25
Non-current liabilities	137	45	30	30	30
Debentures	80	30	30	30	30
Others	57	15	0	0	0
Total liabilities	173	87	55	55	55
Owners of parent equity	380	428	502	582	675
Capital stock	252	252	252	252	252
Capital surplus	6	6	6	6	6
Other reserves	(6)	(12)	(8)	(8)	(8)
Retained earnings	130	182	252	332	425
Non-controlling interest equity	3	3	3	3	3
Shareholders' equity	383	431	505	585	678

Cash flow

FY-ending Dec. (W bn)	2013A	2014A	2015F	2016F	2017F
C/F from operations	89	57	246	141	170
Net profit	52	60	70	79	93
Depreciation	0	0	0	0	0
Amortization	1	0	1	1	1
Net incr. in W/C	(3)	(24)	17	0	0
Others	39	21	158	61	76
C/F from investing	(19)	38	(216)	(127)	(154)
Capex	(0)	(0)	0	0	0
Decr. in fixed assets	0	0	0	0	0
Incr. in investment	(54)	12	75	(1)	(1)
Net incr. in intangible assets	0	(0)	0	0	0
Others	34	27	(291)	(126)	(153)
C/F from financing	(56)	(104)	(12)	(10)	(11)
Incr. in equity	16	0	0	0	0
Incr. in debt	(66)	(89)	(2)	0	0
Dividends	0	(7)	(10)	(10)	(11)
Others	(6)	(8)	0	0	0
C/F from others	0	0	0	0	0
Increase in cash	14	(9)	18	5	5

Note: K-IFRS (consolidated)

Income statement

FY-ending Dec. (W bn)	2013A	2014A	2015F	2016F	2017F
Operating revenue	166	143	142	165	184
Interest income	61	53	30	44	49
Commission income	92	80	86	96	108
Other operating revenue	13	11	10	10	12
Operating expenses	98	62	50	61	62
Interest expenses	9	3	3	2	2
SG&A	28	32	32	35	35
Other operating expenses	62	28	15	24	25
Operating profit	68	81	92	104	122
Non-operating income	1	1	1	1	1
Non-operating expenses	1	1	1	1	1
Earnings before tax	68	80	92	104	122
Income taxes	16	20	22	25	29
Net profit	52	60	70	79	93
Net profit of controlling interest	52	60	70	79	93
EBITDA	68	81	93	105	123

Key financial data

FY-ending Dec.	2013A	2014A	2015F	2016F	2017F
Per-share data (KRW)					
EPS	205	237	277	315	368
BPS	1,517	1,706	2,001	2,316	2,684
DPS	30	40	40	45	50
Growth (%)					
Sales growth	41.1	(13.6)	(0.9)	16.5	11.4
OP growth	14.0	19.4	13.9	13.6	17.1
NP growth	8.9	15.7	16.7	13.6	17.1
EPS growth	8.9	15.7	16.9	13.6	17.1
EBITDA growth	13.7	19.0	14.1	13.4	16.9
Profitability (%)					
OP margin	40.8	56.4	64.8	63.2	66.4
NP margin	31.2	41.8	49.2	48.0	50.4
EBITDA margin	41.3	56.9	65.5	63.8	66.9
ROA	9.1	11.2	13.0	13.2	13.5
ROE	14.7	14.8	15.0	14.7	14.8
Dividend yield	1.8	1.1	1.4	1.6	1.8
Dividend payout ratio	14.5	16.4	14.0	13.9	13.2
Stability					
Net debt (W bn)	80	0	(20)	(25)	(30)
Debt/equity ratio (%)	31.6	7.5	5.9	5.1	4.4
Valuation (x)					
PE	8.0	15.7	10.2	8.8	7.6
PB	1.1	2.2	1.4	1.2	1.0
EV/EBITDA	7.4	11.7	7.5	6.5	5.5

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Note: % of companies under coverage with this rating

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