KKR Real Estate Finance Trust Inc. (KREF)

Updated October 26th, 2021 by Nikolaos Sismanis

Key Metrics

Current Price:	$22.90	**5 Year CAGR Estimate:**	7.0%	**Market Cap:**	$1.27B
Fair Value Price:	$21.53	**5 Year Growth Estimate:**	1.5%	**Ex-Dividend Date:**	15/30/2021[1]
% Fair Value:	106%	**5 Year Valuation Multiple Estimate:**	-1.2%	**Dividend Payment Date:**	01/15/2021
Dividend Yield:	7.51%	**5 Year Price Target**	$23.19	**Years Of Dividend Growth:**	N/A
Dividend Risk Score:	F	**Retirement Suitability Score:**	C	**Last Dividend Increase:**	N/A

Overview & Current Events

KKR Real Estate Finance Trust is a real estate finance company that engages primarily in originating and acquiring transitional senior loans secured by institutional-quality commercial real estate ("CRE") properties. These senior loans are originally owned and operated by experienced and well-capitalized sponsors located in liquid markets with strong underlying fundamentals. The company has a $5.8 billion purpose-built portfolio of senior loans that's 71% secured by multifamily and office properties owned by high-quality sponsors. KREF generates around $150 million in annual revenues and is headquartered in New York, New York.

On October 25th, KREF reported its Q3 results for the quarter ended September 30th, 2021. Revenues grew by 19.7% to $47.78 million year-over-year, with the company originating eight senior loans totaling $1.5 billion. Loans featured a weighted average appraised loan-to-value ratio and coupon of 66% and LIBOR+3.5%, respectively. Consequently, distributable earnings came in at $34.5 million, or $0.62/share, vs. $32.5 million or $0.58/share in Q3-2020.

During the quarter, the company collected 97.4% of interest payments due on its loan portfolio, which, according to management, now has a weighted average risk rating of 3.0 (on a five-point scale). The company is currently benefiting from the low-rate environment, given that 99.9% of its loan portfolio is indexed to one-month USD LIBOR, which stood at just 0.08% at the end of the quarter. In line with the most recent quarter's performance run rate, we hike our FY2021 distributable earnings per share forecast from $2.00 to $2.05.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
DEPS[2]	---	---	---	---	$1.95	$1.61	$1.30	$1.58	$1.67	$1.95	***$2.05***	***$2.21***
DPS	---	---	---	---	$0.73	$1.22	$1.62	$1.69	$1.72	$1.72	***$1.72***	***$1.81***
Shares[3]	---	---	---	---	8.6	19.3	45.3	55.1	57.4	56.0	***56.0***	***70.0***

Since the company's IPO, KREF has rapidly grown its loan portfolio by borrowing at lower rates and issuing shares with a lower cost of equity than the spreads it receives as net interest income by its loan portfolio. The current low-rate environment constitutes a fantastic environment for KREF to leverage its world-renowned manager's (KRR) access to low-cost financing. The company's term loan financing facilities provide KRR matched-term financing on a non-mark-to-market and non-recourse basis. Hence, not only is the company borrowing on the cheap and secures better credits due to its manager's reputation, but also, its liability structure is resilient from a mark-to-market viewpoint, enhancing KREF's ability to manage risk and its liquidity position during less favorable market cycles. While the strategy has worked successfully so far, KREF's future profitability is highly susceptible to higher interest rates, with 99.9% of its portfolio attached to floating rates. For example, if LIBOR was to increase to 0.25%, the impact on the net interest income per share would be ($0.04), while an increase to 1% would cost the company ($0.07) per share, per quarter, or around

[1] Estimated dates based on past dividend dates.
[2] Distributable earnings per share modify GAAP net income (loss) by excluding (i) non-cash equity compensation expense, (ii) depreciation and amortization, (iii) any unrealized gains or losses. It's a proxy of dividend coverage for income-oriented investors.
[3] Share count is in millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

13.6% of its DEPS on an annualized basis. Consequently, we are forecasting a modest earnings growth ahead, of 1.5% per annum. The company has grown its dividend accordingly with its increasing DEPS. Due to the risks associated with mortgage REITs, the possibility for earnings to be easily compressed and only minor room for growth, we are assuming dividends will grow by around 1% in the medium term.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/DE	---	---	---	---	---	---	16.2	12.7	11.7	9.0	***11.2***	***10.5***
Avg. Yld.	---	---	---	---	---	---	7.7%	8.5%	8.8%	9.8%	***7.5%***	***7.8%***

KREF has historically traded with a price to distributable earnings ratio of around 12.4. However, we believe that investors are most likely to value KREF based on its underlying yield and book value due to the company's business model. The yield currently stands at 7.5%, which we expect to slightly grow going forward due to the possibility of a modest valuation multiple headwind. At around 10.5X DEPS, the stock offers a more reasonable risk/reward profile. At the end of the quarter, the company's book value per share stood at $19.09. Shares are currently trading at a notable premium at their current price, even if we account for any accrued dividend value embedded in the stock.

Safety, Quality, Competitive Advantage, & Recession Resiliency

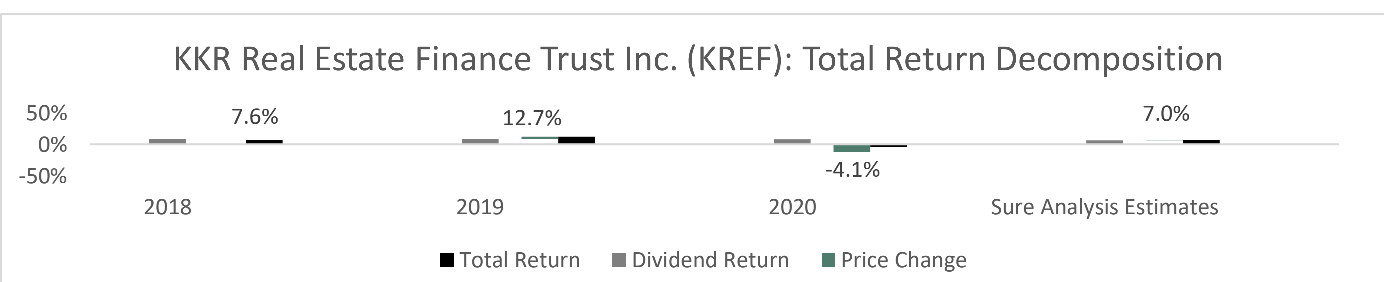
Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	---	---	---	---	37%	76%	125%	107%	103%	88%	***84%***	***82%***

While KREF's dividend is seemingly covered from the underlying distributable net income, there is only a thin margin to prevent a dividend cut in a scenario that would pressure the company's profitability. Hence, we don't consider it highly reliable. That being said, the company enjoys several qualities, including being managed by a leading global investment firm, KRR, which boasts $252 billion of assets under management. The company is also led by a world-class management team of 46 investment professionals who carry decades of experience in the mortgage industry. However, we can't ignore that the company operates in a highly competitive industry with various institutional lenders and investors. Further, a prolonged recession that could result in its borrowers missing on their payment schedule or an increase in interest rates could significantly impact the company's scheduled collections and overall investing spreads.

Final Thoughts & Recommendation

Backed by a credible sponsor, KREF has successfully grown its portfolio since its IPO and produced growing distributable earnings while paying its shareholders a substantial yield. While the favorable rate environment may persist, we remain cautious and predict humble growth rates in the medium term. We forecast annualized returns of 7% in the medium term, powered by KREF's yield, our thin growth expectations, and the possibility for a small valuation headwind. . KREF, therefore, earns a hold rating. We caution that investors need to be wary of the risks attached to mortgage REITs.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue					20	35	65	99	100	126
SG&A Exp.					2	2	5	8	11	14
Net Profit					17	31	59	90	90	54
Net Margin					85.1%	88.4%	90.5%	90.4%	90.2%	43.3%
Free Cash Flow					11	25	54	77	92	115
Income Tax					0	0	1	(0)	1	0

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets					4,717	6,265	7,395	5,232	5,057	4,966
Cash & Equivalents					27	96	103	87	68	111
Accounts Receivable					1	3	8	16	16	15
Total Liabilities					4,431	5,760	6,335	4,097	3,933	3,920
Accounts Payable					5	3	4	12	10	10
Long-Term Debt					122	439	1,046	2,975	3,892	3,879
Shareholder's Equity					281	498	1,059	1,132	1,122	1,044
D/E Ratio					0.43	0.88	0.99	2.62	3.46	3.71

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets						0.6%	0.9%	1.4%	1.7%	1.1%
Return on Equity						8.0%	7.6%	8.2%	8.0%	5.0%
ROIC						4.6%	3.9%	2.9%	2.0%	1.1%
Shares Out.					8.6	19.3	45.3	55.1	57.4	56.0
Revenue/Share					0.38	0.68	1.44	1.80	1.73	2.24
FCF/Share					0.22	0.48	1.19	1.39	1.59	2.05

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.