



KKR Real Estate Finance Trust Inc. (KREF)

Updated October 24th, 2023 by Nikolaos Sismanis

Key Metrics

Current Price:	\$10.46	5 Year CAGR Estimate:	16.6%	Market Cap:	\$722.9 M
Fair Value Price:	\$12.95	5 Year Growth Estimate:	1.5%	Ex-Dividend Date:	12/29/2023 ¹
% Fair Value:	81%	5 Year Valuation Multiple Estimate:	4.4%	Dividend Payment Date:	01/12/2024
Dividend Yield:	16.4%	5 Year Price Target	\$13.95	Years Of Dividend Growth:	N/A
Dividend Risk Score:	F	Retirement Suitability Score:	C	Rating	Buy

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 an \$7.9 billion purpose-built portfolio of senior loans that is primarily secured by multifamily and office properties owned by high-quality sponsors. KREF generates around \$185 million in net interest income and is headquartered in New York, New York.

On October 23rd, 2023, KREF reported its Q3-2023 results for the quarter ending September 30th, 2023. For the quarter, total net interest income fell by 5.7% year-over-year to roughly \$44.6 million, as interest expenses advanced at a more significant rate than interest income. During the quarter, the company funded \$164.9 million for loans closed in previous quarters and received loan repayments of \$152.3 million.

Distributable earnings came in at \$17.4 million, or \$0.25/share, compared to \$33.1 million, or \$0.48/share, in Q2-2023. The notable decline was due to a \$15.0 million write-off. During the quarter, the company collected 96% of interest payments due on its loan portfolio, which, according to management, now has a weighted average risk rating of 3.2 (on a five-point scale). The company’s floating rate loan portfolio is now benefiting from rising rates amid a rotation out of higher rate-floor loans. Accordingly, we believe the company has a DEPS power of \$1.85.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
DEPS²	---	---	\$1.95	\$1.61	\$1.30	\$1.58	\$1.67	\$1.95	\$1.63	\$1.62	\$1.85	\$1.99
DPS	---	---	\$0.73	\$1.22	\$1.62	\$1.69	\$1.72	\$1.72	\$1.72	\$1.72	\$1.72	\$1.72
Shares³	---	---	8.6	19.3	45.3	55.1	57.4	55.6	59.4	69.1	69.1	90.0

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 from its loan portfolio. The previously low-rate environment constituted 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 also 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 securing better credits due to its manager’s reputation but also, its liability structure is resilient from a mark-to-market viewpoint. This enhances 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 susceptible to changes in interest rates, with 100% of its portfolio attached to floating rates. Based on its current portfolio composition, a 0.5% and a 1.0% increase in one-month SOFR would boost the quarterly net interest income per share by \$0.07 and \$0.14, respectively. Thus, the ongoing rising-

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.



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rates environment could benefit KREF, assuming its own financing remains cheap. 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. However, due to the risks associated with mortgage REITs, earnings to be easily compressed, while there is only minor room for growth. Combined with a rather uncertain real estate market, we expect no dividend growth ahead.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/DE	---	---	---	---	16.2	12.7	11.7	9.0	13.0	11.1	5.7	7.0
Avg. Yld.	---	---	---	---	7.7%	8.5%	8.8%	9.8%	8.1%	9.6%	16.4%	12.3%

KREF has historically traded with an average price-to-distributable earnings ratio of 12.3. 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. Shares are down year-over-year, which has pushed their yield to 16.4%. While this could signal the market is pricing the stock for a dividend cut, we believe the company will sustain its current level of payouts. Consequently, we also believe the stock is considerably undervalued here, especially given that KREF is benefiting from the ongoing rise in rates. At the end of the quarter, the company's book value per share stood at \$16.29, implying shares are trading at a 35%+ discount to NAV.

Safety, Quality, Competitive Advantage, & Recession Resiliency

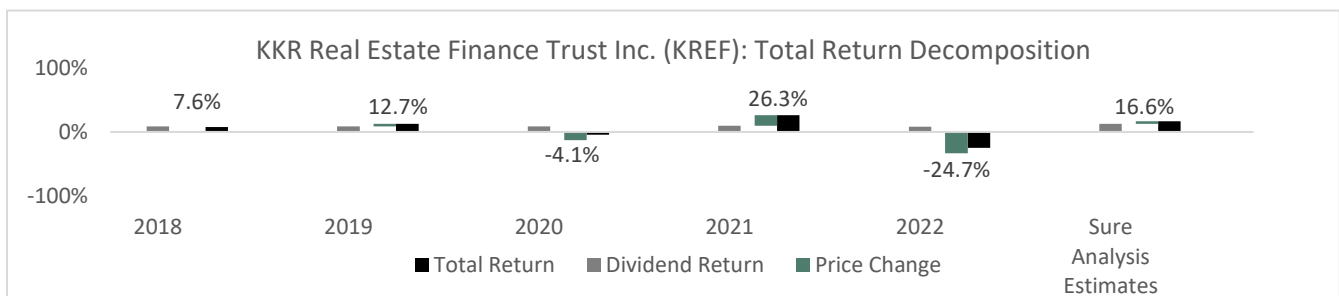
Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	---	---	37%	76%	125%	107%	103%	88%	106%	106%	93%	86%

KREF's dividend is barely covered by the underlying distributable net income, and 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 \$519 billion of assets under management. The company is also led by a world-class management team of around 150+ 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 their payment schedule or an increase in interest rates could significantly impact the company's scheduled collections and overall investing spreads.

Final Thoughts & Recommendation

Despite the underlying challenges that come with a treacherous macro environment, KREF's loan portfolio is benefiting, with 100% of its loans linked to floating rates. We forecast annualized returns of 16.6% in the medium-term, powered by KREF's 16.4% yield, our growth estimates, and the potential for a 4.4% annual valuation tailwind. While we do not completely dismiss the possibility of a dividend cut, we believe the market's concerns regarding this outcome are likely exaggerated. KREF, therefore, earns a buy rating. We caution that investors need to be wary of the risks attached to mortgage REITs, nonetheless.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	---	---	20	35	65	99	100	126	152	175
SG&A Exp.	---	---	2	2	5	8	11	14	14	18
Net Profit	---	---	17	31	59	90	90	54	137	38
Net Margin	---	---	85.1%	88.4%	90.5%	90.4%	90.2%	43.3%	90.1%	21.7%
Free Cash Flow	---	---	11	25	54	77	92	115	---	141
Income Tax	---	---	0	0	1	(0)	1	0	0.7	0.1

Balance Sheet Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total Assets	---	---	4,717	6,265	7,395	5,232	5,057	4,966	6,703	7,802
Cash & Equivalents	---	---	27	96	103	87	68	111	271	240
Accounts Receivable	---	---	1	3	8	16	16	15	15	39
Total Liabilities	---	---	4,431	5,760	6,335	4,097	3,933	3,920	5,342	6,231
Accounts Payable	---	---	5	3	4	12	10	10	14	28
Long-Term Debt	---	---	122	439	1,046	2,975	3,892	3,879	5,295	6,164
Shareholder's Equity	---	---	281	498	1,059	1,132	1,122	1,044	1,361	1,571
LTD/E Ratio	---	---	0.43	0.88	0.99	2.62	3.46	3.71	3.89	3.92

Profitability & Per Share Metrics

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Return on Assets	---	---	---	0.6%	0.9%	1.4%	1.7%	1.1%	2.4%	0.5%
Return on Equity	---	---	---	8.0%	7.6%	8.2%	8.0%	5.0%	11.4%	2.6%
ROIC	---	---	---	4.6%	3.9%	2.9%	2.0%	1.1%	2.4%	0.5%
Shares Out.	---	---	8.6	19.3	45.3	55.1	57.4	56.0	56.9	67.6
Revenue/Share	---	---	0.38	0.68	1.44	1.80	1.73	2.24	2.68	2.59
FCF/Share	---	---	0.22	0.48	1.19	1.39	1.59	2.05	---	2.09

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

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