KKR Real Estate Finance Trust Inc. (KREF)

Updated February 7th, 2024 by Nikolaos Sismanis

Key Metrics

Current Price:	$10.10	**5 Year CAGR Estimate:**	9.0%	**Market Cap:**	$700.7 M
Fair Value Price:	$9.78	**5 Year Growth Estimate:**	1.5%	**Ex-Dividend Date:**	03/27/2024
% Fair Value:	103%	**5 Year Valuation Multiple Estimate:**	-0.7%	**Dividend Payment Date:**	04/15/2024
Dividend Yield:	9.9%	**5 Year Price Target**	$10.53	**Years Of Dividend Growth:**	N/A
Dividend Risk Score:	F	**Retirement Suitability Score:**	C	**Rating**	Hold

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 $7.8 billion purpose-built portfolio of senior loans that is primarily secured by multifamily and office properties owned by high-quality sponsors. KREF generates around $182 million in net interest income and is headquartered in New York, New York.

On February 6th, 2024, KREF reported its Q4 and full-year 2023 results for the quarter ending December 31st, 2023. For the quarter, total net interest income fell by 10.4% year-over-year to roughly $44.5 million, as interest expenses advanced at a more significant rate than interest income. During the quarter, the company funded $138.7 million for loans closed in previous quarters and received loan repayments of $188.1 million.

Distributable earnings came in at approximately negative $26 million, or negative $0.37/share, versus $12.4 million, or $0.18/share last year. The notable decline was due to a $58.7 million write-off. Thus, distributable earnings per share plunged to $0.83 for the year. During the year, the company 97.6**%** 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. Still, the underlying borrows are struggling, with this year's notable default eroding KREF's financials. Thus, the company was forced to cut its dividend by roughly 42% to a quarterly rate of $0.25. For FY2024, we, forecast DEPS of $1.15.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
DEPS[1]	---	$1.95	$1.61	$1.30	$1.58	$1.67	$1.95	$1.63	$1.62	$0.83	***$1.15***	***$1.24***
DPS	---	$0.73	$1.22	$1.62	$1.69	$1.72	$1.72	$1.72	$1.72	$1.72	***$1.00***	***$1.00***
Shares[2]	---	8.6	19.3	45.3	55.1	57.4	55.6	59.4	67.6	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

[1] 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.
[2] Share count is in millions.

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 $0.02 and $0.03, respectively. Thus, the ongoing rising-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 most recent dividend cut illustrates the notable risks associated with mortgage REITs, whose earnings can be easily compressed. We expect no dividend growth ahead while KREF tries to find its footing following last year's notable client default.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/DE	---	---	---	16.2	12.7	11.7	9.0	13.0	11.1	14.9	***8.8***	***8.5***
Avg. Yld.	---	---	---	7.7%	8.5%	8.8%	9.8%	8.1%	9.6%	13.9%	***9.9%***	***9.5%***

KREF has historically traded with an average price-to-distributable earnings ratio of 12.6. 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 recent dividend cut led to a significant drop in share prices, resulting in a renewed high yield. Additionally, the balance sheet suffered from $73.7 million in write-offs last year, contributing to the share price decline. As of the quarter's end, the company's book value per share stands at $15.52, indicating a trading discount of over 35% to NAV. Despite this, we expect a heavy discount to be sustained due to diminishing trust in the stock following the recent dividend reduction and investor skepticism towards KREF's borrowers.

Safety, Quality, Competitive Advantage, & Recession Resiliency

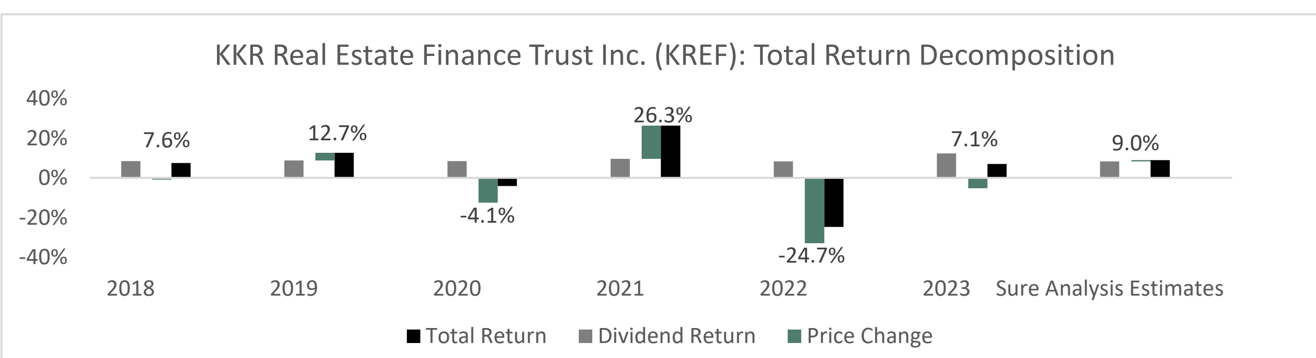
Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout		37%	76%	125%	107%	103%	88%	106%	106%	207%	***87%***	***81%***

KREF's reduced dividend, though supported by current distributable net income, lacks high reliability. Further, despite positive factors like management by KRR with $553 billion in assets, and a skilled team of 150+ professionals, KREF faces intense competition in the mortgage industry. Additionally, a recession or higher interest rates pressuring borrowers may adversely affect scheduled collections and investing spreads. Overall, KREF is a quality company in the space, but operates in a very risky industry.

Final Thoughts & Recommendation

We forecast annualized returns of 9.0% in the medium-term for KREF, powered by its 9.9% yield, our growth estimates, and the possibility of a modest annual valuation headwind. Following the recent dividend cut, distributions are likely to remain covered, offering investors a notable yield. However, we remain skeptical of its future prosperity. Shares earn a hold 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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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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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.