Asia Credit Research

Earnings Review: Keppel Corp Ltd ("KEP")

Issuer Profile: Neutral (4)

Ticker: **KEPSP**

Background

Listed in 1986, Keppel Corp Ltd ("KEP") is a diversified conglomerate based in Singapore, operating in the real estate, offshore & marine ("O&M"), infrastructure, logistics, mobile data centres and asset management sectors. KEP owns a ~79%-stake in Keppel Telecommunications and Transportation Ltd ("KPTT"). Two other significant associates are Keppel REIT (46%-stake) and Keppel Infrastructure Trust ("KIT", ~18%-stake). KEP is ~20.5%-owned by Temasek.

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Recommendation

- With its purchase of M1, Singapore's third largest mobile player, KEP is transforming into an even more diversified conglomerate.
- In 4Q2018, M1's reported profit before tax was SGD31.5mn versus KEP's profit before tax of SGD158mn (adjusting out the income contribution from KEP's initial 19%-stake in M1).
- In addition to M1, KEP is also taking private KPTT, investing more money into Keppel Infrastructure Trust and expanding its asset management business – all which would tilt net gearing upwards from end-2018's 0.48x. On the back of expectations of KEP's higher leverage profile, we had in October 2018 lowered KEP's issuer profile to Neutral (4) and maintaining it as such.
- In our view, the KEPSP curve trades tight. At the short-end, we prefer the SCISP 3.7325% '20s which is trading at a 69bps spread versus the KEPSP 3.1% '20s which is trading at 60bps spread. For investors looking for higher yield, we prefer the Starhub Ltd's STHSP 3.08% '22s which is trading at 104bps spread which more than compensates for the two years longer maturity. While STHSP has been plagued by negative headlines, we think the decline in credit profile may be stemmed by its dividend cuts. We hold SCISP at an issuer profile of Neutral (4) while hold STHSP and CAPLSP at Neutral (3).

Relative Value:

Bond	Maturity/Call date	Net gearing	Ask Yield to Maturity	Spread
KEPSP 3.1% '20s	12/10/2020	0.48x	2.58%	60bps
KEPSP 3.145% '22s	14/02/2022	0.48x	2.82%	84bps
SCISP 3.7325% '20s	09/04/2020	1.1x	2.69%	69bps
CAPLSP 4.3% '20s	31/08/2020	0.56x	2.62%	63bps
STHSP 3.08% '22s	12/09/2022	NM[1]	3.04%	104bps

Indicative prices as at 27 February 2019 Source: Bloomberg
Net gearing based on latest available quarter
STHSP reported net debt-to-TTM EBITDA of 1.52x for 2018

Key Considerations

- **4Q2018 Property down mainly due to lack of fair value gains:** In 4Q2018, KEP reported a 14% y/y decline in revenue to SGD373mn although profit before tax ("PBT") fell even more by 40% y/y to SGD215mn. We infer that for Property Trading, 1,260 units were sold in 4Q2018 versus 1,690 units in 4Q2017 and for those that were sold, we think KEP's average selling price each units were lower. For the full year 2018, KEP achieved sales value of ~SGD1.8bn on 4,440 units versus ~SGD2.8bn on 5,480 units sold in 2017 (ie: average selling price per unit on an overall basis had fallen 26% y/y). We think this was due to the tilt towards high volume but lower priced housing markets. For full year 2018, PBT was up significantly by 41% y/y to SGD1.2bn, driven by China en-bloc sales. While KEP's residential property business is still present in Singapore, it is mainly focused on China (eg: Tianjin and Chengdu, Wuxi) and Vietnam, with Indonesia and India being growth markets for KEP. The lower Property-segment PBT in 4Q2018 was mainly due to lower fair value gains recognized on investment properties (SGD36.6mn in 4Q2018 versus SGD177.9mn in 4Q2017). KEP own a portfolio of commercial buildings (largely offices) in Singapore, China, Vietnam, Indonesia and the UK on a wholly-owned basis. While associate Keppel REIT's ("KREIT", Issuer Profile: Neutral (4)) results were weaker in 4Q2018, aggregate leverage had improved to 36.3% from a high of 39.1% in 3Q2018.

- **Buying new infrastructure asset:** This segment includes the contribution from KIT and KPTT (Issuer Profile: Neutral (4)) although KPTT only makes up 6% of Infrastructure revenue), it made up 41% of Infrastructure PBT. In 4Q2018, KEP's

Infrastructure revenue grew 25% y/y to SGD744mn, driven by higher sales in power and gas business and revenue recognition from the Keppel Marina East Desalination plant (4th desalination plant in Singapore) which KEP is constructing. Nonetheless, PBT was down 4% y/y at SGD50mn. The decline is attributable to the loss-making Logistics business at KPTT (4Q2018 loss before tax of SGD15.2mn versus 4Q2017's profit before tax of SGD18.9mn). Furthermore, we think the power generation business is loss-making. KEP has a ~58%-effective interest in Keppel Merlimau Cogen via an outright 49%-ownership and its 18%-stake in KIT. The plant is consolidated at the KIT level although most of the operating cost is passed through to Keppel Electric (100% owned by Keppel). In November 2018, KIT announced the proposed acquisition of IXOM (a supplier and distributor of water treatment, industrial and specialty chemicals company in Australia and New Zealand) for an enterprise value of ~SGD1.07bn where part of the funding would come from additional shareholders equity including from KEP.

- **Investments segment dragged by impairments:** KEP's revenue for the Investments segment was SGD40mn (up 33% y/y) while losses before tax was SGD4.0mn for 4Q2018. This is in sharp contrast with 4Q2017 where the segment delivered profit before tax of SGD45mn. The Investments segment consist of a myriad of businesses, including asset management (via Keppel Capital), urban solutions, 40%-stake in KrisEnergy Ltd and KPTT's then 19%-stake in M1 Limited ("M1"). Apart from lower profits from Keppel Capital and Sino-Singapore Tianjin Eco-City ("SSTEC"), 4Q2018 results were dragged by share of losses at KrisEnergy and a SGD53mn in impairment was also taken on an associate. While no further details were provided, we would not be surprised if this relates to KrisEnergy (31 December 2018 book value of equity of USD0.5mn, down from USD97.6mn as at 30 September 2018).

- **Beyond data centre and office asset management:** While asset management tends to be "asset-light", capital commitments is required for the business (eg: as seed capital). We think this is more so as Keppel Capital focuses on private real estate asset management and entering into new verticals (retirement communities, Australian shopping malls, early childhood facilities) which it lacks a track record in. In end-2018, Keppel Capital's asset under management was SGD29bn. While the updated outstanding capital commitments is undisclosed, we earlier estimated that KEP would need to fund ~SGD595mn for the asset management segment in the near term. KEP is also mobilising Keppel Capital to invest alongside its clients. On 26 February 2019, KEP announced that Keppel Capital will be taking a 30%-stake in Gimi MS Corporation ("Gimi"). Gimi, which would be 70%-owned by Golar, a key KEP O&M client, is developing a Floating Liquefied Natural Gas ("FLNG") facility via KEP's yards. KEP is committing to invest up to USD250mn (~SGD337mn) in the project. In effect, KEP would assume a "developer" role for this project, rather than just a shipbuilder.

- **Losses at Offshore & Marine ("O&M") driven by provisions:** In 4Q2018, O&M reported SGD520mn in revenue (up 6% y/y) although the segment reported a loss before tax of SGD97mn (4Q2017: loss before tax, excluding one-off Brazil related penalty of SGD256mn). In 4Q2018, the O&M segment took SGD167mn in of provisions in relation to Sete Brasil contracts (4Q2018: SGD81mn was taken). While details were lacking, per management, the level of provisions taken in relation to the Sete Brasil contracts is believed to be sufficient for now. The decline in profits though was partly offset by a SGD96.4mn write-back of provision of claims (from a rig contract claim where the first of such provisions were taken 10 years ago). In our view, this means that the provision effectively sat at KEP as a "reserve". In end-2018, net orderbook (excluding Sete Brasil contracts) was SGD4.3bn (30 September 2018: SGD4.4bn). On an operating level, O&M was encouragingly profitable for 2018 before taking into account of provisions and impairments.

- **Mobile operator M1 in the bag:** In September 2018, KEP and Singapore Press Holdings ("SPH") via their jointly owned entity Konnectivity Pte Ltd ("Konnectivity") announced the proposed takeover offer of M1 Ltd ("M1"). At time of announcement, the largest determinant to KEP's investment outlay was the response of Axiata Group Bhd ("Axiata", then the largest owner of M1 with a

28.7%-stake). It was then uncertain if Axiata would mount a competing offer. On 15 February 2019, Axiata accepted Konnectivity's takeover offer. Including stakes originally held, shares from Axiata and shares from other minority shareholders who have tendered, Konnectivity held ~76%-stake in M1. We think more shareholders would tender by closing date on 4 March 2019, where KEP would pay the total maximum cash outlay of ~SGD1.28bn.

- **Expect net gearing to tilt upwards in 2019:** As at 31 December 2018, KEP's net gearing was 0.48x, rising from 0.41x in the previous quarter while EBITDA/Interest coverage had decline to 3.5x from 4.8x in 4Q2017. Going forward, we think KEP's net gearing to rise to at least ~0.6x as we expect KEP to fund the M1 purchase with debt and consolidate the SGD450mn debt held by M1. We further expect KEP to take up debt to fund the take-private of KPTT (~SGD227mn investment outlay), equity injection into KIT (~SGD137mn investment outlay) and make further investments into the asset management business in the coming 12 months.

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Explanation of Issuer Profile Rating ("IPR") / Issuer Profile Score ("IPS")

Positive ("Pos") – The issuer's credit profile is either strong on an absolute basis, or expected to improve to a strong position over the next six months.

Neutral ("N") – The issuer's credit profile is fair on an absolute basis, or expected to improve / deteriorate to a fair level over the next six months.

Negative ("Neg") – The issuer's credit profile is either weaker or highly geared on an absolute basis, or expected to deteriorate to a weak or highly geared position over the next six months.

To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings ("IPR") into a 7 point Issuer Profile Score ("IPS") scale.

IPR	Positive		Neutral			Negative	
IPS	1	2	3	4	5	6	7

Explanation of Bond Recommendation

Overweight ("OW") – The performance of the issuer's specific bond is expected to outperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Neutral ("N") – The performance of the issuer's specific bond is expected to perform in line with the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Underweight ("UW") – The performance of the issuer's specific bond is expected to underperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Other

Suspension – We may suspend our issuer rating and bond level recommendation on specific issuers from time to time when OCBC is engaged in other business activities with the issuer. Examples of such activities include acting as a joint lead manager or book runner in a new issue or as an agent in a consent solicitation exercise. We will resume our coverage once these activities are completed.

Withdrawal ("WD") – We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

Analyst Declaration

The analyst(s) who wrote this report and/or her or his respective connected persons did not hold financial interests in the above-mentioned issuer or company as at the time of the publication of this report.

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