Asia Credit Research

Earnings Review: Keppel Corp ("KEP")

Issuer Profile:
Neutral (3)

Ticker: **KEPSP**

Background
Listed in 1986, Keppel Corp Ltd ("KEP") is a diversified conglomerate based in Singapore, operating in the offshore & marine ("O&M"), real estate, and infrastructure sectors. Its principal activities include offshore oil rig construction, shipbuilding and repair, environmental engineering, power generation, property investment and development, and the operation of logistics and data centre facilities. Keppel operates in more than 30 countries internationally, and is 21%-owned by Temasek Holdings Ltd.

Nick Wong Liang Mian, CFA
+65 6530-7348
NickWong@ocbc.com

Recommendation

- In general, KEP has managed to monetize its balance sheet and improve its credit profile, with O&M deliveries being crystalized while residential inventory being consumed. That being said, we recognize some potential revenue slowdown in its core businesses in the near term. We will retain our Neutral (3) Issuer Profile.
- In general, we find the KEPSP curve to be either fully valued, or rich. We prefer the FHREIT 3.08% '24s which offer similar YTM (for one year extension) versus the KEPSP 3.725% '23s as though we hold both KEP and Frasers Hospitality Trust ("FHT") at Neutral (3), the latter is likely to have a more stable credit profile.

Relative Value:

Bond	Maturity/Call date	Net Gearing	Ask Yield	Spread
KEPSP 3.725% '23s	30/11/2023	42%	3.25%	82bps
FHREIT 3.08% '24s	08/11/2024	49%	3.25%	75bps

Indicative prices as at 23 April 2018 Source: Bloomberg
Net gearing based on latest available quarter

Key Considerations

- **Non-recurring property results lift group performance**: KEP reported 1Q2018 results, with total revenue up 17.8% y/y to SGD1.47bn. The Property segment drove the bulk of group revenue gains with revenue up more than 100% y/y to SGD544.3mn. This drove segment pre-tax profit to SGD455.3mn (1Q2017: SGD113.4mn). Performance was largely non-recurring, driven by the divestment of Keppel China Marina Holdings ("KCMH") with KEP recognizing a SGD289mn divestment net gain for the quarter. KCMH was the same asset that had faced minority stakeholder objection, though this looks to have been resolved. With Singapore inventories declining (launched units only 183 left unsold) and overall slowdown in China (163 units sold during 1Q2018 versus 3561 units sold for 2017), there may be some segment revenue pressure in the near future. Already, residential units sold for the quarter fell sharply to 300 units (1Q2017: 980 units). The resurgence in Singapore residential property market has led management to resume considering the conversion of Keppel Towers into condominiums. The Serangoon North Ave 1 plot (~613 units over 462,561 sqft GFA) was indicated to be launched later this year.

- **Weak O&M performance, though green shoots seen**: O&M segment revenue continues to decline (-31.3% y/y to SGD332.1mn) due to reduced volume of work done. This was in line with our expectations (refer to OCBC Asian Credit Daily (26 Jan 2018)) as net value left for execution for 2018 was low. The remaining 9 months of 2018 stands at just SGD165mn. The segment managed to generate SGD8mn in operating profit (SGD4mn in 1Q2017), though losses at associates dragged the segment to a net loss of SGD23mn. O&M orderbook stands at SGD4.3bn, up from SGD3.9bn (end-2017) due largely to the USD425mn semi-sub order win from Awilco Drilling (first newbuild drilling asset order since the downturn begun in 2015). KEP's net orderbook exposure to drilling assets (excluding Sete Brasil rigs) is actually very low at just SGD1.3bn. Biggest exposure is the SGD2.1bn to Floating Production Storage and Offloading vessels ("FPSOs") and Floating Liquefied Natural Gas ("FLNGs"). The sale of rigs to Borr Drilling looks to be on track (these were formerly ordered by Transocean), with KEP delivering the first of five rigs during 1Q2018. One area of interest would be how management indicated a desire to be both an owner and operator of floating energy infrastructure, as part of their end-to-end gas strategy, potentially utilizing more of KEP's balance sheet towards this end.

- **Infrastructure profits still muted**: The Infrastructure segment revenue grew 20.6% y/y to SGD569.1mn, supported by continued improvements in its power and gas business (higher HSFO prices have supported the domestic power business), as well as progressive revenue recognized on the Keppel Marina East Desalination Plant project. Segment net profit eased to SGD26mn (1Q2017: SGD32mn) on the absence of the divestment gain from GE Keppel Energy Services Pte Ltd seen in the prior period. The Investment division reported a pre-tax loss of SGD40mn (1Q2017: SGD141mn pre-tax gain) due to the absence of sale of three land parcels at Tianjin Eco-City as well as the impact of fair value losses on KrisEnergy warrants.

- **Monetization of balance sheet supports credit profile**: The KCMH divestments helped group profit surge 27.3% y/y to SGD334.1mn. KEP saw operating cash outflow of SGD10.3mn, largely due to working capital needs (increase in inventory and receivables, while payables declined), though levels are lower than the SGD45.0mn outflow seen in 1Q2017. We note as well that the sizable SGD359.2mn cash outflow to creditors may have included the part of the Brazil penalties as guided by management previously (37.5% of ~SGD570mn). The KCMH divestment helped boost investing cash flows to SGD246.9mn. KEP also increased net borrowings by SGD277.2mn. These caused KEP's cash balance to increase by SGD453.4mn to SGD2.70bn. Though gross borrowings increased, net gearing improved q/q from 46% to 42%. Short-term borrowings of SGD1.68bn can be met by the SGD2.70bn cash balance.

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Explanation of Issuer Profile Rating / Issuer Profile Score

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 into a 7 point Issuer Profile Score 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 securities in the above-mentioned issuer or company as at the time of the publication of this report.

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