Asia Credit Research

Earnings Review: Keppel Telecommunications & Transportation ("KPTT")

- Despite the challenging environment at KPTT's Logistics business, KPTT receives regular dividends from its associate companies and as such we maintain KPTT's issuer profile at Neutral (4).
- KPTTSP 2.85% '24 (with a call date in September 2022) is trading at a YTW of 3.46% and a YTM of 3.57%. Should KPTT not call the bond in September 2022, the coupon rate will rise by 100bps to 3.85% p.a. We assume that the bonds will be called in September 2022 at par.
- While we expect KPTT's profile to be more levered going forward, we think the 50bps differential between the KPTT 2.85% '24 and ARTSP 4.205% '22 more than compensates for this and recommend a switch into the KPTT 2.85% '24s. We also hold ARTSP's issuer profile at Neutral (4).

Relative Value:

Bond	Maturity/Call date	Aggregate leverage	Ask Yield to Worst	Spread
KPTT 2.85% '24	05/09/2022	31.1%	3.46%	113
ARTSP 4.205% '22	23/11/2022	36.1%	2.98%	63

Indicative prices as at 23 April 2018 Source: Bloomberg
Aggregate leverage based on latest available quarter; Debt-to-adjusted total assets for KPTT, less assets held for sale

Issuer Profile: Neutral (4)

Ticker: **KPTTSP**

Background

Keppel Telecommunications & Transportation Ltd ("KPTT") focuses on three businesses, namely logistics, data centres and investment holding. Within data centres, KPTT also holds a ~30.0% stake in Keppel DC REIT ("KDC REIT"). KPTT's main investments under the investment holding business is a ~19.3% stake in M1 Ltd, a major telco focused on the Singapore market. KPTT is ~79.4% owned by Keppel Corp Ltd.

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Key Considerations

- **Decline in profitability despite top line growth:** Reported gross revenue was up 5.1% y/y to SGD42.8mn. In 1Q2018, Data Centre made up 20% of total revenue and contributed the most to the y/y growth in revenue, driven by higher facility and project management fee income. KPTT owns 70% in Almere Data Centre 2, Netherlands and revenue from this data centre operations is consolidated into KPTT's top line. On a top line basis, the Logistics segment makes up 80% of revenue. In 1Q2018, revenue from Logistics declined 2.2% y/y. Despite only a 5.1% increase in overall revenue, operating expenses increased 7.7% y/y to SGD47.0mn mainly due to higher transportation, contract labour and subcontractor costs in the Logistics division and increase in staff costs from higher headcount. KPTT reported a wider operating loss of SGD3.4mn (operating loss of SGD1.7mn in 1Q2017). Interest expense was 14.9% lower as borrowing levels were lower in 1Q2018 against 1Q2017. As a holding company, KPTT's share of results of associates and joint ventures ("JCE") is a significant contributor to bottom line, chiefly, its stakes in KDC REIT, M1 Ltd and 50%-stake in KDC REIT's REIT Manager ("KDCREITM"). In 1Q2018, JCEs contributed SGD16.0mn versus SGD16.6mn in 1Q2017. Profit for the period to shareholders was SGD9.4mn in 1Q2018 (down 16.3% y/y).

- **Status of divestments:** In November 2017, KPTT had appointed financial advisers to assist on a strategic review of its underperforming China logistics portfolio (including a potential sale), though as of report date there has been no updates yet. KPTT does not provide the revenue split between China and other regions for its Logistics business. We note though that in FY2017, China made up 32% of total revenue and this is likely to be mainly attributable to Logistics. Despite the potential for a disposal of China Logistics to hit revenue, a sale would in our view narrow the losses at the Logistics segment. In March 2017, KPTT's entire 10% shareholding in Asia Airfreight Terminal ("AAT") was put up for sale for HKD250mn (~SGD41.9mn) to Hong Kong Airlines (a unit of HNA Group). The sale is conditional on the sale of other shareholders in AAT (ie: SATS Ltd and Kerry Logistics). As of report date, a sale has not been completed and we do not assume this cash infusion will occur in the near-term in our base case.

- **Capital recycling in Data Centre business:** Majority of data centre assets are held at KDC REIT (14 data centre assets, investment properties valued at SGD1.7bn) and Alpha DC Fund. This is a data centre focused private equity fund set up by KPTT (via its 70%-owned subsidiary Keppel Data Centre Holding ("KDCH")) and sister company Alpha Investment Partners Limited (owned by Keppel Corp). In mid-2017, KPTT sold the Keppel DC Singapore 4 data centre to Thorium Pte Ltd (30:70 owned by KPTT and Alpha DC Fund) for SGD170.0mn. KPTT's effective interest in Alpha DC Fund had reduced following an outside investor's participation in the fund. We note that in October 2017, a Canadian pension fund committed to invest an initial USD350mn in the fund (with a further USD150mn upsize option) which would bring asset under management to USD2.3bn when fully leveraged and invested. KPTT has not fully paid up its commitment amounts and subject to future capital calls at Alpha DC Fund.

- **Large commitments may tilt net gearing upwards:** As at 31 March 2018, reported net gearing (including amount owed to associates) was 0.4x (relatively flat against end-2017). Going forward though, we continue to expect debt levels to increase as KPTT funds its commitments progressively. As of end-2017, capital commitments at KPTT had ballooned to SGD337.8mn from only SGD250.6mn in end-2016. In end-2017, 96% of these relate to commitment to purchase shares in other companies which we think is the outstanding commitment to Alpha DC Fund. Adjusting debt upwards for this amount, we find adjusted net gearing at 0.7x.

- **Dividends receipt a significant credit driver:** KPTT receives significant and recurring cash dividends from associates, including from M1 Ltd (Singapore's third largest telecommunications company) and KDC REIT. For the full year 2017, cash dividends received was SGD46.9mn, and taking a quarter of these into EBITDA, we find adjusted EBITDA/Interest at 5.1x in 1Q2018 (versus the thin unadjusted EBITDA/Interest of 0.5x before adding in cash dividends). We note that dividends from M1 Ltd have been falling on the back of a challenging domestic telecommunications market. The cash gap of SGD9.4mn at KPTT was funded by an increase in net borrowings during the quarter.

- **Short term debt coming due:** SGD133.6mn in short term debt will be coming due in the next 12 months (representing 28% of total debt) against cash balance of SGD111.8mn, posing some refinancing risk at KPTT. Of KPTT's debt, only 1.3% of total debt consists of secured debt. In end-2017, 71% of KPTT's fixed assets were made up of leasehold land and buildings. Assuming this proportion stayed constant as at 31 March 2018, we estimate that KPTT has SGD342.9mn in investment properties, leasehold land and buildings, giving KPTT the financial flexibility to raise more secured financing facilities, if need be.

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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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