

Earnings Review: Keppel Telecommunications & Transportation Ltd (“KPTT”)

Recommendation

- KPTT’s parent company, Keppel Corp (“KEP”) has announced the proposed purchase of all stakes in KPTT it does not already own. Our base case assumes that the proposed take-private transaction would be successful, with KPTT eventually delisted from the Singapore Stock Exchange and subsumed as a wholly-owned subsidiary of KEP. There is no change of control and no delisting put on the KPTTSP 2.85% ‘24s (with a call date in September 2022). Should the take-private be successful, bondholders would hold the bonds of an unlisted wholly-owned subsidiary of KEP (we hold KEP’s issuer profile at Neutral (4)). We are currently maintaining KPTT’s issuer profile at Neutral (4) though would cease coverage of KPTT should the transaction go through.
- The KPTTSP ‘24s is trading at a YTW of 3.54% and a YTM of 3.64%. 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 KPTTSP as a standalone privately-held entity will not have similar capital market access and income diversification as KEP, we see the 26 bps spread between the KPTTSP ‘24s and the KEPSP ‘23s as too wide. Going by the trading level of KPLDSP ‘23s, issued by Keppel Land (Issuer profile: Unrated), the gap may narrow when KPTTSP becomes a wholly-owned subsidiary of KEP. Keppel Land is a privately-held wholly-owned subsidiary of KEP which was taken private by KEP in July 2015. We are Overweight the KPTTSP ‘24s.

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 ~25.0% 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 (“KEP”).

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Relative Value:

Bond	Maturity/Call date	Net gearing	Ask YTW	Spread
KPTTSP 2.85% ‘24c22	05/09/2022	31.3%	3.54%	131bps
KPLDSP 2.843% ‘23	05/09/2023	NA	3.28%	99bps
KEPSP 3.725% ‘23	30/11/2023	41.3%	3.35%	104bps

Indicative prices as at 29 October 2018 Source: Bloomberg

Net gearing based on latest available quarter; Keppel Land (KPLDSP) is a privately-held subsidiary of KEP, standalone net gearing is not publicly available

Key Considerations

- **Stronger top line:** In 3Q2018, revenue has increased 6.6% y/y to SGD47.9mn, driven by higher data centre facility management income (we estimate that Data Centre segment revenue was up 35% y/y) and increase in revenue from the warehousing channel and channel management business. Nonetheless, the overall Logistics segment would have still seen relatively flat revenue based on our estimation as these were offset by lower revenue from port operations in China. In 4Q2017, KPTT embarked on a strategic review with regards to its struggling China Logistics portfolio though as yet there have been no updates to the process.
- **Reported operating loss:** Despite the stronger top line, KPTT reported an operating loss of SGD4.0mn (3Q2017 operating profit of SGD3.2mn) driven by higher staff and other costs to drive top line growth. 3Q2017 also saw a large one-off gain on the partial disposal of the Keppel DC Singapore 4 data centre into the Alpha Data Centre Fund (“Alpha DC Fund”). This was absent in 3Q2018. Nonetheless, share of results of associated companies and joint ventures was up 25% y/y to SGD20.1mn (3Q2017: SGD16.1mn) which helped KPTT report a profit for the period of SGD12.5mn during the quarter (3Q2017: SGD14.9mn). Share of profits from 19%-owned M1 Ltd would have declined, with M1 Ltd reporting a 5.5% y/y decline in net profit to SGD34.5mn in 3Q2018. We think the increase in share of profits from associates and joint ventures was attributable to Keppel DC Singapore 4 which has since been de-recognised as a subsidiary but now

recognised as an associated company.

- **Flat q/q net gearing though tilting up from obligations to Alpha DC Fund:** As at 30 September 2018, unadjusted net gearing was 0.3x, relatively flat versus 30 June 2018. In our view, this has not fully reflected capital call obligations at Alpha DC Fund, a data centre focused real estate private equity fund set up by KPTT and Alpha Investment Partners Limited (“AIP”, indirectly wholly-owned by KPTT’s parent company KEP). KPTT holds its minority stake in the Alpha DC Fund via its 70%-owned subsidiary Keppel Data Centres Holding Pte Ltd (“KDC Holding”). Keppel Land (yet another of KPTT’s sister company, wholly-owned by KEP) owns the remaining 30%-stake in KDC Holding. In June 2018, KPTT announced that together with Keppel Land, they would lend SGD378mn to KDC Holding where KDC Holding will use these monies to fund its Alpha DC Fund obligation. KPTT would be lending SGD264.6mn, with Keppel Land coming up with the rest. As at 31 March 2018 (available balance sheet date before announcement), KPTT’s cash balance was only SGD111.8mn and insufficient to cover the SGD264.6mn fully. In our view, KPTT would need to raise the SGD264.6mn to have sufficient cash to on-lend to KDC Holding. With KDC Holding consolidated at the KPTT level and KPTT’s cash balance insufficient to fund the full amounts, we expect KPTT to progressively take on more debt to fund such capital commitments.
- **Manageable refinancing risk:** The sale of KPTT’s 10%-stake in Asia Airfreight Terminal (“AAT”) to a subsidiary of Hong Kong Airlines has yet to be completed despite the signing of a conditional sales and purchase agreement on 17 March 2017. Given the delays, we do not factor this sale as a source of liquidity (HKD250m/SGD44.0mn). In any case, as at 30 September 2018, short term debt at KPTT was SGD71.3mn, representing only 15% of total debt. With a miniscule SGD9.0mn of assets (out of SGD1.6bn of total assets) encumbered, we see minimal refinancing risk at KPTT as we think KPTT has the ability to raise secured financing or borrow money from its related companies, if need be.
- **Take-private in progress:** KEP already owns a ~79%-stake in KPTT and KEP is proposing to buy the stakes it does not already own in KPTT for a maximum of SGD226.6mn in cash. Additionally, KEP has announced a pre-conditional voluntary general offer for M1 Ltd (together with M1 Ltd’s third largest shareholder, Singapore Press Holding). We think a take-private of KPTT is par for course given the cross-holdings between KPTT and various entities within the KEP structure (eg: in data centre, M1 Ltd). A take-private at this point allows KEP to simplify KPTT’s corporate structure while also allowing KPTT’s minority shareholder to cash out.
- **Bondholders of KPTT likely to hold bonds of an unlisted wholly-owned subsidiary of KEP:** Our base case assumes that the proposed take-private transaction would be successful, with KPTT eventually delisted from the Singapore Stock Exchange and subsumed as a wholly-owned subsidiary of KEP. We are currently maintaining KPTT’s issuer profile at Neutral (4) though would cease coverage of KPTT should the transaction go through. In our view, it is unlikely for standalone KPTT financials to be made available publicly post delisting, though we continue to maintain coverage on KEP. There is no change of control and no delisting put on the KPTTSP 2.85% ‘24s. Should the take-private be successful, bondholders would hold the bonds of an unlisted wholly-owned subsidiary of KEP (we hold KEP’s issuer profile at Neutral (4)).

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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.

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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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