OCBC Bank

Issuer Profile:

Neutral (4)

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Neutral (4)

Ticker:

KEPSP

Ezien Hoo, CFA
+65 6722 2215
EzienHoo@ocbc.com

Keppel Corp Ltd ("KEPSP")

Recommendation

- **On 21 October 2019, Temasek announced its voluntary pre-conditional offer for KEP to increase its stake in KEP to ~51% (from the current ~21%-stake). Our base case assumes that the deal will get done.**
- **In our view, there is no certainty that Temasek's ownership stake in KEP is going to stay constant over time given Temasek's investment holding profile with full flexibility to reshape and rebalance its portfolio. Historically, we note that Temasek has taken majority control of certain investee companies and subsequently sold them down.**
- **KEP is involved in broad sectors which allows a new controlling shareholder (via influence on its board) to reshape it in multiple ways. This means that until we know what is planned for KEP, event risk is heightened during this period which we think should lead to a steepening of the KEP curve.**
- **Overall, we think the development is positive for the short end of KEP's curve though neutral-to-negative for the medium-long dated end of the curve.**
- **Despite the rise in bond price post Temasek's announcement, the KEPSP 3.1% '20s still trades at 72bps, wider versus Sembcorp Industries Ltd ("SCI"), Issuer profile: Neutral (5) SCISP 3.7325% '20s trading at 38bps and we think that the KEPSP 3.1% '20s should grind tighter to where the SCISP 3.7325% '20s are trading. While KEPSP is significantly more diversified versus SCISP, it overlaps with SCISP in the infrastructure and offshore & marine segments. If the pre-conditional offer is taken up, KEP and SCI will also share the same single largest shareholder (in SCISP's case Temasek holds a ~49%-stake in the company).**
- **At the middle-to-longer end, the SCISP curve trades ~30-50bps wider versus KEPSP. Given the event risk, we think this part of KEP's curve should trade wider until a concrete strategic review plan is unveiled. For now, we are maintaining KEP's issuer profile at Neutral (4) and monitoring the developments.**

Relative Value:

Bond	Maturity / Call date	Net gearing	Ask YTM/YTC	Spread
KEPSP 3.1% '20s	12/10/2020	0.88x	2.20%	72bps
KEPSP 3.145% '22s	14/02/2022	0.88x	2.46%	99bps
KEPSP 3.725% '23s	30/11/2023	0.88x	2.64%	113bps
KEPSP 3.0% '24s	07/05/2024	0.88x	2.72%	119bps
KEPSP 3.0% '26s	01/10/2026	0.88x	2.92%	129bps
KEPSP 3.8% '27c22s	23/04/2022	0.88x	2.67%	120bps
KEPSP 3.66% '29s	07/05/2029	0.88x	3.29%	157bps
KEPSP 4.0% '42c32s	07/09/2032	0.88x	3.79%	199bps
SCISP 3.7325% '20s	09/04/2020	1.08x	1.89%	38bps
SCISP 2.94% '21s	26/11/2021	1.08x	2.54%	108bps
SCISP 3.64% '24s	27/05/2024	1.08x	3.03%	150bps

Indicative prices as at 30 October 2019 Source: Bloomberg
Net gearing based on latest available quarter

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. Among KEP's significant associates are: Keppel REIT, Sino-Singapore Tianjin Eco-City Investment and Development Co, Limited, Keppel DC REIT, Floatel International Limited and Keppel Infrastructure Trust.
- KEP is currently ~21%- owned by Temasek Holdings (Private) Limited ("Temasek") with the remaining shareholding dispersed across institutional and retail investors.

Key Considerations

- **Partial offer for KEP with KEP to remain listed:** Temasek's wholly-owned subsidiary Kyanite Investment Holdings Pte Ltd ("Kyanite") announced a voluntary pre-conditional partial offer for ~30.55%-stake in KEP for a total of ~SGD4.0bn. While such a transaction (involving increasing stakes beyond 30%) typically triggers a mandatory takeover offer, Kyanite has obtained consent from the Securities Industries Council ("SIC") to make a partial offer. The offer price, to be fully paid in cash at SGD7.35 per share represents a 26% premium to KEP's last traded price. Given the lackluster performance of KEP's traded equity performance in recent years, we think this encourages shareholders to tender their shares and our base case assumes that Temasek will become the single largest shareholder of KEP holding ~51%-stake in KEP (~52%-stake including concert parties).

- **Significant changes looming:** Prior to Temasek's surprise move, KEP had been in the midst of a transformation, among the most significant changes, investing heavily into new areas (eg: telecommunications, asset management) and targeting new types of clients in a bid to turnaround its offshore & marine ("KOM") business with some successes. KEP had also aimed to have each of its key division contribute no more than 40% of its annual net profit over the long term. In our view, the impending introduction of Temasek as majority shareholder of KEP is likely to lead to changes in KEP's strategic direction. While Temasek is not involved in day-to-day operations, we can reasonably expect that a major shareholder via board representation is able to accelerate strategic change at the company. Already, we have seen Temasek announcing (1) Its intention to work with KEP's board to undertake a comprehensive strategic review of the KEP business to create sustainable value for its shareholders and (2) It may propose new directors to KEP's board. Additionally, the media has reported that Temasek may be looking to merge KOM with Sembcorp Marine Ltd ("SMM", 61%-owned by SCI) as a response to shipbuilding consolidation in North Asia. Prior to the partial takeover announcement, we had not assumed this as base case given that a merger/purchase of a struggling SMM was unlikely to be in the best interest of KEP's investors across its capital structure.

- **KEP has a finger in the pie across broad sectors:** While we think it is premature to come to a conclusion on what Temasek has in mind for its stake in KEP, possibilities which the future KEP board can consider are wide-ranging. KEP's larger businesses cover property development, infrastructure, O&M, telecommunications, data centres, logistics, real estate asset management and investment while smaller businesses include various energy-related associates and lithium battery. Among the possibilities include:
    - i) A merger between SMM and KOM, given that Temasek is the single largest shareholder of SCI (and hence SMM). Additionally, Temasek also subscribed to SCI's recent bond issue.
    - ii) A merger between SCI and KEP itself to create an "international champion", in a similar manner as CapitaLand Ltd (Issuer profile: Neutral (3)) and Ascendas-Singbridge.
    - iii) (3) A merger or collaboration between M1 Ltd and Starhub or roll-up with other telecommunication and data centre assets owned by Temasek.

  Enlarged businesses could subsequently be spun-off to generate shareholder value and there are no guarantees that KEP's business segments will stay constant. Net-net, event risk is heightened at KEP during this period until such time a concrete strategic review plan is unveiled to the market.

- **All of KEP's main segments saw top-line growth in 3Q2019:** KEP's gross revenue was SGD2.1bn for 3Q2019, growing 59.6% y/y. For 9M2019, gross revenue was SGD5.4bn, growing 25.5% y/y. Revenue growth in 3Q2019 was driven by all of KEP's main segments, namely Investments, Infrastructure, Offshore & Marine and Property. On a profit before tax basis ("PBT"), KEP's profit before tax for 3Q2019 was down by 32.3% y/y to SGD227.0mn.

The decline was driven by the Property segment, which saw lack of en-bloc sales during the quarter. As part of KEP's business model, it sells properties en-bloc and in 3Q2018, KEP recorded SGD173.7mn in gains from the sale of property projects in China. During the quarter, KEP sold ~1,400 housing units, lower than in 3Q2018 though throughout 9M2019, housing unit sales were robust at 3,520 units (mainly in China and Vietnam) and higher than the 3,150 units during the same period last year. While having reduced, Property continues to be the biggest profit driver at KEP, contributing 54% to total 3Q2019 PBT and 65% of 9M2019 PBT.

- **Infrastructure as the second profit driver:** In 3Q2019, KEP's Infrastructure segment reported SGD92mn in PBT (making up 41% of total PBT). This segment includes its share of associates from Keppel Infrastructure Trust ("KIT", Issuer profile: Neutral (4)), which now includes results from IXOM, acquired by KIT in 1Q2019. Energy and Environmental Infrastructure performed better and per KEP, the Infrastructure segment also recorded dilution gains from Keppel DC REIT ("KDC REIT")'s equity private placement in September 2019. These were partly offset by lower contribution from Infrastructure Services and the logistics business (parts of which is in the midst of being sold).

- **Other segments somewhat profitable on a PBT basis:** Offshore & Marine managed to generate a PBT of SGD8mn in 3Q2019 though lower than 3Q2018 by ~SGD2mn. As at 30 September 2019, KEP's net orderbook was SGD5.1bn (end-2018: SGD4.3bn), of which 67% was related to gas solutions and LNG projects, new areas which KEP had been targeting. With regards to the settlement agreement with Sete Brasil, KEP continues to view that its SGD476mn in provisions previously taken is adequate. For Investments, KEP recorded only ~SGD4.0mn in PBT in 3Q2019 against SGD20mn in 3Q2018. Despite consolidating M1's results and recording higher share of profit from the Sino-Singapore Tianjin Eco City from land plots sold, KEP took a SGD17mn charge on amortization of intangibles, funding costs and professional fees and recorded higher share of losses from 40%-owned KrisEnergy Ltd ("KrisEnergy"") as well as fair value losses on KrisEnergy warrants.

- **Stable 3Q2019 credit metrics:** Based on our calculation, 3Q2019 EBITDA (which does not include other income and other expenses) was SGD288.6mn while interest expense (including lease liabilities) was SGD85.9mn, which leads us to derive EBITDA/Interest coverage of 3.4x (3Q2018: 3.4x). KEP's unadjusted net gearing (inclusive of lease liabilities) was 0.88x as at 30 September 2019 versus 0.82x as at 30 June 2019 (end-2018: 0.48x), mainly due to debt funding taken for the M1 acquisition. The q/q change was mainly due to higher investing outflow with KEP making further advances and investments into an associate while working capital continues to be consumed for its Offshore & Marine business. As at 30 September 2019, short term debt and short term lease liabilities KEP were collectively significant at SGD4.3bn, and representing 37% of its gross debt. KEP's secured debt represents only 3.4% of total tangible assets which should facilitate market access, notwithstanding the event risks at the company.

- **Asset monetization a small credit positive:** In September 2019, KEP announced that its indirect subsidiary will be selling a 99%-stake in a data centre, namely Keppel DC Singapore 4 ("KDC 4") located in Tampines, Singapore to KDC REIT. The REIT is sponsored by a KEP subsidiary while KEP indirectly holds a 25.4%-associate stake in this REIT. KDC REIT will fund the purchase of KDC 4 in part by a preferential offering of equity to existing unitholders, including KEP. The extraordinary general meeting at KDC REIT to approve the deal (given this is a related party transaction) was completed on 23 October 2019 with the REIT's equity holders approving the deal. Adjusting downwards for the equity injection into KDC REIT, we expect KEP to record a net investment inflow of ~SGD320mn in 4Q2019. The asset monetization of an asset into KDC REIT should help pare down reported net gearing by about 3% to ~0.85x, though insufficient to move the needle in terms of our issuer profile on KEP.

- **KrisEnergy debt restructuring an overhang:** In September 2019, KrisEnergy, a small upstream oil and gas company was put under debt moratorium to undertake a court supervised debt-reorganisation. We believe KEP may need to take further impairments as (1) KEP is both an equity holder as well as a debtholder at the KrisEnergy level with SGD131mn in its direct investments which is KEP's valuation on its equity stake in KrisEnergy, bonds and warrants as at 30 June 2019; and (2) KEP is also responsible or has the key economic exposure for a USD200mn (~SGD273mn) revolving credit facility extended to KrisEnergy by a bank lender. We had earlier expressed that we see the likelihood of KEP providing additional financial assistance to KrisEnergy as high, though with the impeding change in majority shareholder, any decision on KrisEnergy would likelier be deferred, to the extent possible.

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

Please note that Bond Recommendations are dependent on a bond's price, underlying risk free rates and an implied credit spread that reflects the strength of the issuer's credit profile. Bond Recommendations may not be relied upon if one or more of these factors change.

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.

Treasury Research & Strategy

Macro Research

Selena Ling
Head of Strategy & Research
LingSSSelena@ocbc.com

Tommy Xie Dongming
Head of Greater China Research
XieD@ocbc.com

Wellian Wiranto
Malaysia & Indonesia
WellianWiranto@ocbc.com

Terence Wu
FX Strategist
TerenceWu@ocbc.com

Howie Lee
Thailand, Korea & Commodities
HowieLee@ocbc.com

Carie Li
Hong Kong & Macau
carierli@ocbcwh.com

Dick Yu
Hong Kong & Macau
dicksny@ocbcwh.com

Credit Research

Andrew Wong
Credit Research Analyst
WongVKAM@ocbc.com

Ezien Hoo
Credit Research Analyst
EzienHoo@ocbc.com

Wong Hong Wei
Credit Research Analyst
WongHongWei@ocbc.com

Seow Zhi Qi
Credit Research Analyst
ZhiQiSeow@ocbc.com