Issuer Profile:

Neutral (4)

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Neutral (4)

Ticker:

KEPSP

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Keppel Corporation Limited ("KEP")

Recommendation

- KEP announced to the market a reaffirmation of its Vision 2030 strategic plan to focus on four redefined business segments (1) Energy & Environment (2) Urban Development (3) Connectivity and (4) Asset management. Key focus businesses include renewables, environmental solutions, nearshore floating infrastructure, connectivity solutions and integrated smart district development.
- In our view the new businesses build upon the company's core skills but focuses on serving customers' green and sustainability needs.
- KEP has also provided updates to its strategic plans. The company has identified SGD17.5bn of assets that can be sold down progressively where the proceeds can be used to be invested into new growth areas. Concurrently the company has announced that it will be commencing a strategic review of its offshore & marine ("KOM") business through both organic and inorganic options which includes mergers and disposals.
- We are <u>maintaining Keppel at Neutral (4) for now, though tentatively, given that specific reorganisation steps have not been released</u>. The identified assets for divestment are significant, representing 55% of KEP's total asset of SGD32.0bn as at 30 June 2020. While KEP's equity value had been trading below book for more than a year, its landbank and properties are carried at cost which suggest possible upside if sold at market value. We may lower KEP's issuer profile if the company ends up with having a smaller income stream or asset base without a concurrent reduction in debt.
- Bond Recommendation: We continue to like the KEP callable bonds and within its own curve, we prefer the belly of the curve which yields between 2.5 – 2.8%. At the short end, while the KEPSP 3.145% '22s looks attractive versus SCISP 2.94% '21s, bonds from smaller issuers such as Mapletree North Asia Commercial Trust ("MNACT", Issuer profile: Neutral (4)) and GuocoLand Ltd ("GUOL", Issuer profile: Neutral (5)) are paying more than 2% and we prefer to take those names instead. The KEPSP 3.66% '29s provides a 50bps pick-up against CAPLSP 3.15% '29s, which in our view compensates for the credit differentiation and looks attractive at the long end in a yield compressed market. While not in the same industry sector, we hold Sembcorp Industries Ltd at Neutral (4) and CapitaLand Ltd at Neutral (3)). All three have Temasek as a key shareholder.

Relative Value:

Bond	Maturity / Call date	Net gearing	Ask YTM/YTC	Spread	Recommendation
KEPSP 3.145% '22s	14/02/2022	1.0x	1.96%	173bps	UW
KEPSP 3.725% '23s	30/11/2023	1.0x	2.31%	197bps	N
KEPSP 3.0% '24s	07/05/2024	1.0x	2.46%	210bps	OW
KEPSP 2.459% '25s-USD-denominated	04/06/2025	1.0x	2.56%[1]	213bps[1]	OW
KEPSP 3.0% '26s	01/10/2026	1.0x	2.78%	223bps	OW
KEPSP 3.8% '27c22s	23/04/2022	1.0x	2.53%	230bps	OW
KEPSP 3.66% '29s	07/05/2029	1.0x	3.14%	241bps	N
KEPSP 4.0% '42c32s	07/09/2032	1.0x	3.80%	290bps	OW
SCISP 2.94% '21s	26/11/2021	1.6x	1.65%	143bps	UW*
SCISP 3.64% '24s	27/05/2024	1.6x	2.29%	193bps	N*
CAPLSP 3.15% '29s	29/08/2029	0.6x	2.64%	190bps	N*

Indicative prices as at 30 September 2020 Source: Bloomberg
Net gearing based on latest available quarter
Note: (1) In implied-SGD terms
** Based on Monthly Credit View (03 September 2020)*

Background

- Listed in 1986, Keppel Corp Ltd ("KEP") is a diversified conglomerate operating in the real estate, offshore & marine ("KOM"), infrastructure, logistics, telecommunications, data centres and asset management sectors. As at 30 September 2020, KEP has a market cap of SGD8.1bn.
- Significant associates include: Keppel REIT, Sino-Singapore Tianjin Eco-City Investment and Development Co, Limited, Keppel DC REIT, and Floatel International Limited.
- KEP is currently ~21%-owned by Temasek Holdings (Private) Limited ("Temasek"). The remaining shareholding is dispersed across institutional and retail investors.

Key Considerations

- **Stepping up KEP's transformation:** Prior to Temasek's announcement in October 2019, KEP was already in the midst of a transformation. Various critical steps were carried out in the past few years since the oil crash of 2014, including diversifying its shipbuilding capabilities and the acquisition of M1 Ltd. An overall coordinated vision though was only revealed to the market in May 2020. Yesterday, KEP had announced to the market a reaffirmation of its Vision 2030 strategic plan and various strategic updates. These updates come six weeks after Temasek walked away from the conditional partial takeover of the company following KEP's breach of a pre-condition due to asset impairments at KOM. In October 2019, Kyanite Investment Holdings Pte. Ltd, an indirect wholly-owned subsidiary of Temasek announced a partial takeover offer of KEP which, if successful, would have seen Temasek become a 51%-shareholder of KEP. We had earlier expected that the deal would be successful with strategic change at KEP sped up.

- **What is Vision 2030?** Under Vision 2030, KEP would focus on four redefined business segments (1) Energy & Environment (2) Urban Development (3) Connectivity and (4) Asset management. KEP already carries out some of the activities entailed under Vision 2030. For example, KEP is a significant developer, owner and operator of township development, data centres and infrastructure assets (eg: power plants, water and waste management). Key focus businesses include renewables, environmental solutions, nearshore floating infrastructure, connectivity solutions and integrated smart district development. In our view, the new businesses build upon the company's core skills but focuses on serving customers' green and sustainability needs. As an example, data centres are considered to be a polluting industry particularly on carbon emissions due to its high energy consumption needs. In April 2020, KEP entered into a memorandum of understanding ("MOU") with Toll Group to study the feasibility of developing floating data centres nearshore at sites around Singapore. A separate MOU was signed with Royal Vopak to study using LNG to power and cool down data centres. This was followed by a June 2020 announcement where KEP and Mitsubishi Heavy Industries will explore using hydrogen power as a cleaner energy source for data centres. While these sound newfangled, in September 2017, KEP was an early investor in a floating data centre startup Nautilus Data Technologies. In April 2019, KEP invested USD50mn to take an undisclosed minority stake in a lithium-ion battery company and even more recently the company has entered into a joint venture to develop a customer rewards business.

- **From a conglomerate to an integrated company:** Under Vision 2030, KEP has emphasized that it is pulling business activities together in an operationally integrated manner, with the changes being communicated to the broader market. Going forward, KEP would also be disclosing its segmental information based on the four business segments compared to the current segmentation based on KOM, Property, Infrastructure and Investments. We view the redefined segmentation positively as the Investments segment in particular had become unwieldy, making it difficult for the investment community to track its progress.

Figure 1: Redefined business segments

Energy & Environment	Urban Development	Connectivity	Asset Management
KOM	Keppel Land	M1 Ltd	Keppel Capital
Keppel Infrastructure	Keppel Urban Solutions	Keppel Data Centres	Private funds
Keppel Renewable	Sino-Singapore Tianjin	Keppel Logistics	Listed REITs & trusts

Energy KrisEnergy	Eco-city

Source: Company presentation as at 28 May 2020

Figure 2: Current business segments

Offshore & Marine	Property	Infrastructure	Investments
KOM Floatel Dyna-Mac	Keppel Land Keppel REIT	Keppel Infrastructure Keppel Data Centres Keppel Logistics Keppel Infrastructure Trust	Keppel Capital Private funds Managers of listed REITs & trusts M1 Ltd KrisEnergy Keppel Renewable Energy Keppel Urban solutions Sino-Singapore Tianjin Eco-city

Source: Company annual report 2019

- **On the path to having a smaller asset base:** KEP has a stated long term goal of achieving 15% return on equity ("ROE"). Along with Keppel Capital (where third parties will jointly own investments with KEP), asset disposals in our view will be critical to reaching this ROE target. As such, while it may take time to dispose all the assets identified, directionally it is more likely that KEP would push to get these done. The company has identified SGD17.5bn in carrying value of assets, not including its shipyards and units in REITs and trusts, that can be sold down progressively where the proceeds can be used to be invested into new growth areas. Breakdown of the identified assets are as follows: (1) SGD7.0bn relates to landbank and projects under development (2) SGD4.8bn relates to assets that can be monetised via REITs/trust and sales to third parties (3) SGD3.9bn in non-core assets such as rigs still owned by KOM and (4) SGD1.8bn from other investments and funds that can be liquidated overtime. Of the assets identified, SGD3-5bn is targeted to be monetised in the next three years.

- **What happens to KOM?** Concurrently, KEP announced that it will be commencing a strategic review of this offshore and marine business, organic and inorganic options which include mergers and disposal are being considered. In our view, any plans on the shipyards will be part of this strategic review. KOM's closest peer Sembcorp Marine Ltd ("SMM", Issuer profile: Unrated) is now ~43%-owned by Temasek, following the spin-off from Sembcorp Industries Ltd ("SCI", Issuer profile: Neutral (4)). While equity investors have long held on hopes of an eventual merger of KOM and SMM, we do not think it is as simplistic given the specific exclusion of shipyards from the SGD17.5bn and steps which KEP has organically undertaken at its shipyards, including LNG vessels and autonomous vessels. Additionally, a digital shipyard would not be out of step with KEP's Connectivity business. In any case, we would rather wait and see before concluding that a merger is in the works. A separate strategic review for its Logistics business in China was announced in November 2017 with a partial divestment occurring in 2019. A review for other parts of the logistics business is on-going.

- **Stage has been set though devil is in the details for credit:** While a carve out of KOM (should it happen) is a near term credit positive, given that this business had been loss-making with asset values impaired, in our view, a "steady-state" issuer profile for KEP ultimately depends on the capital structure of the company following its reorganization. We may lower KEP's issuer profile if the company ends up with having a smaller income stream or asset base without a concurrent reduction in debt. The identified assets for divestments are significant, representing ~55% of KEP's total asset of SGD32.0bn as at 30 June 2020. While KEP's equity value had been trading below book for more than a year, its landbank and properties are carried at cost which suggest possible upside if sold at market value. We do not have the carrying value of rigs alone, though we are assuming this to be SGD3.9bn, being the disclosed value of non-core assets identified for sale. KOM still has another SGD5.0bn of assets as KOM's total assets as at 30 June 2020 was SGD8.9bn. Using this assumption, SGD17.5bn would represent an even larger reduction of ~65% in KEP's assets, excluding the remaining asset value at KOM. As captured in our credit update dated 7 August 2020, KEP's unadjusted net gearing ratio is relatively high with EBITDA/Interest coverage below 3.0x. KEP's unadjusted net gearing exceeded 0.7x following its acquisition of M1 Ltd , completed in April 2019, from a low of 0.4x prior to the acquisition announcement. After hovering around 0.8x to 0.9x in 2019 and 2020, KEP's unadjusted net gearing increased to 1.0x as at 30 June 2020 from impairments and a higher average debt level.

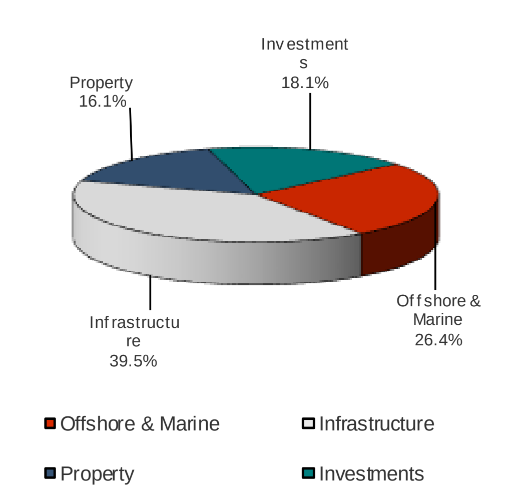
Keppel Corp Ltd

Table 1: Summary Financials

Year End 31st Dec	FY2018	FY2019	1H2020
Income Statement (SGD'mn)			
Revenue	5,964.8	7,579.7	3,182.5
EBITDA	789.3	1,149.9	391.8
EBIT	606.9	774.6	190.7
Gross interest expense	198.4	312.7	156.8
Profit Before Tax	1,239.9	953.5	-357.3
Net profit	956.1	761.1	-536.1
Balance Sheet (SGD'mn)			
Cash and bank deposits	1,981.4	1,783.5	2,426.4
Total assets	26,606.3	31,321.6	31,988.0
Gross debt	7,548.5	11,657.1	13,243.1
Short term debt	1,480.8	4,622.6	5,492.8
Net debt	5,567.1	9,873.6	10,816.7
Shareholders' equity	11,587.1	11,646.0	10,813.3
Cash Flow (SGD'mn)			
CFO	168.9	-706.9	-302.1
Capex	254.5	516.8	237.8
Acquisitions	403.9	1,795.6	374.6
Disposals	1,270.5	149.3	192.4
Dividend	546.5	429.6	240.6
Free Cash Flow (FCF)	-85.6	-1,223.6	-539.9
Key Ratios			
EBITDA margin (%)	13.23	15.17	12.31
Net margin (%)	16.03	10.04	-16.85
Gross debt to EBITDA (x)	9.56	10.14	16.90
Net debt to EBITDA (x)	7.05	8.59	13.80
Gross Debt to Equity (x)	0.65	1.00	1.22
Net Debt to Equity (x)	0.48	0.85	1.00
Gross debt/total assets (x)	0.28	0.37	0.41
Net debt/total assets (x)	0.21	0.32	0.34
Cash/current borrowings (x)	1.34	0.39	0.44
EBITDA/Total Interest (x)	3.98	3.68	2.50

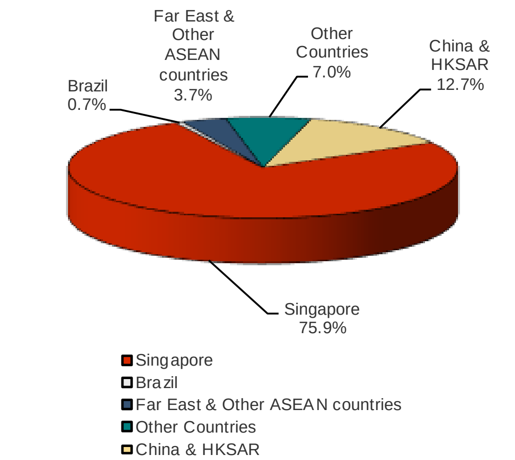
Source: Company, OCBC estimates

Figure 1: Revenue breakdown by Segment - 1H2020



Source: Company

Figure 2: Revenue breakdown by Geography - 1H2020



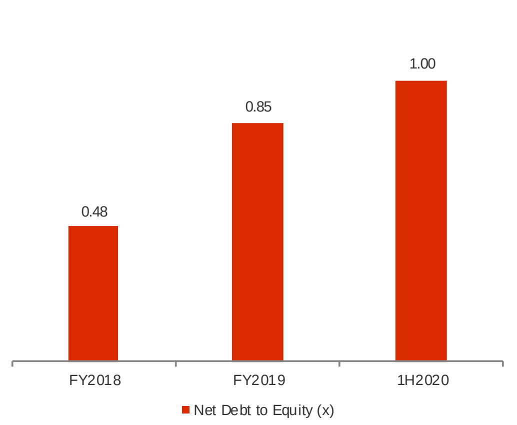
Source: Company

Figure 3: Debt Maturity Profile

Amounts in (SGD'mn)	As at 30/06/2020	% of debt
.		
Amount repayable in one year or less, or on demand		
Secured	164.6	1.2%
Unsecured	5,328.2	40.2%
	5,492.8	**41.5%**
Amount repayable after a year		
Secured	1,139.3	8.6%
Unsecured	6,611.0	49.9%
	7,750.3	**58.5%**
Total	**13,243.1**	**100.0%**

Source: Company

Figure 4: Net Debt to Equity (x)



Source: Company, OCBC estimates

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 bond represents **better relative value** compared to other bonds from the same issuer, or bonds of other issuers with similar tenor and comparable risk profile.

Neutral ("N") – The represents **fair relative value** compared to other bonds from the same issuer, or bonds of other issuers with similar tenor and comparable risk profile.

Underweight ("UW") – The represents **weaker relative value** compared to other bonds from the same issuer, or bonds of other issuers with similar tenor and comparable risk profile.

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.

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