Issuer Profile:

Neutral (4)

⬇

Neutral (5)

Ticker:

KEPSP

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Keppel Corporation Limited ("KEP")

Recommendation

- **Since the reaffirmation of KEP's Vision 2030 plan, KEP had announced multiple divestments and a more organic plan where its offshore & marine business will be split into three divisions. While a more organic plan means that losses at KOM may not be stemmed immediately, we are heartened that the company is taking steps to contain the issues at the rig busines.**
- **Based on our calculation, we find adjusted EBITDA for 2020 at SGD689.4mn, down only 35% y/y which indicate a level of resiliency of KEP's income generation through the pandemic. Adjusted EBITDA/Interest coverage was 2.2x for 2H2020 while total debt-to-adjusted EBITDA was stretched at 18.3x (2019: 10.9x). As at 31 March 2021, KEP's reported unadjusted net gearing was lower at 0.88x (0.91x as at end-2019) though this is likely to be temporary as proceeds are deployed into new growth areas such as renewable energy.**
- **KEP has high capital commitments to areas including its private funds business, investment properties and new projects where KEP holds joint ventures and minority stakes in. While Floatel's debt restructuring had completed, we expect KEP to be taking a hit to its book value equity from a further impairment at KrisEnergy and a cash outflow of SGD247mn to "make-whole" a bank lender at KrisEnergy.**
- **On the back of credit negative event cumulation , higher leverage (including from off-balance sheet debt), looming capital expenditure and somewhat compressed financial capacity, we are lowering our issuer profile of KEP to Neutral (5) from Neutral (4). We will consider lifting the issuer profile should KEP's on-going efforts to boost its income generation materializes and/or its leverage levels decline. Our issuer profile for KEP has historically been on a standalone basis without factoring in Temasek uplift and this remains the same.**
- **Bond Recommendation: We are broadly neutral the KEPSP curve given that it is now trading wider than Sembcorp Industries Ltd ("SCI", Issuer profile: Neutral (4)) though we are underweight the short dated part of the curve due to tight valuations and Overweight the USD-denominated KEPSP 2.459% '25s. In implied-SGD terms, this tranche provides better value versus the rest of the KEPSP curve at 2.64% for a 4Y paper.**

Relative Value:

Bond	Maturity / Call date	Net gearing	Ask YTM/YTC	Spread	Recommen-dation
KEPSP 3.145% '22s	14/02/2022	0.88x	0.91%	57bps	UW
KEPSP 3.725% '23s	30/11/2023	0.88x	1.50%	91bps	N
KEPSP 3.0% '24s	07/05/2024	0.88x	1.63%	96bps	N
KEPSP 2.459% '25s-USD-denominated	04/06/2025	0.88x	2.64%[1]	176bps[1]	OW
KEPSP 3.0% '26s	01/10/2026	0.88x	2.22%	109bps	N
KEPSP 3.8% '27c22s	23/04/2022	0.88x	0.83%	47bps	UW
KEPSP 3.66% '29s	07/05/2029	0.88x	2.61%	115bps	N
KEPSP 4.0% '42c32s	07/09/2032	0.88x	3.43%	173bps	OW
SCISP 3.64% '24s	27/05/2024	1.99x	1.47%	79bps	N*
SCISP 4.25% '25s	30/08/2025	1.99x	1.78%	84bps	N*
SCISP 3.593% '26s	26/11/2026	1.99x	2.06%	91bps	OW*
CAPLSP 3.8% '24s	28/08/2024	0.68x	1.47%	73bps	UW*
CAPLSP 3.08% '27s	19/10/2027	0.68x	2.25%	96bps	UW*
CAPLSP 3.15% '29s	29/08/2029	0.68x	2.59%	111bps	UW*
CAPLSP 2.9% '32s	21/09/2032	0.68x	2.90%	119bps	UW*

Indicative prices as at 04 May 2021 Source: Bloomberg
Net gearing based on latest available financials and business updates
Note: (1) In implied-SGD terms
**Based on Monthly Credit View (05 April 2021)*

Background

- Listed in 1986, Keppel Corp Ltd ("KEP")'s businesses are now segmented into Energy & Environment, Urban Development, Connectivity and Asset Management. As at 4 May 2021, KEP has a market cap of SGD9.7bn.
- Significant associates include: Keppel Real Estate Investment Trust ("KREIT", Issuer profile: Neutral (4)), Keppel DC REIT, Sino-Singapore Tianjin Eco-City Investment and Development Co, Limited, 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.
- In October 2019, Temasek announced a voluntary pre-conditional partial offer for a ~31% stake in KEP which would have seen Temasek's stake in KEP rise to ~51%, if successful. However, owing to impairments in 2020 (which breached a material adverse change clause), Temasek through an indirect wholly-owned subsidiary announced that it would not proceed with the partial offer in August 2020.

Key Considerations

- **Highlights from 1Q2021 business update:** KEP reported revenue of SGD1.9bn in 1Q2021, which is in line with 1Q2020. All segments were profitable with the exception of Keppel Offshore & Marine ("KOM").

    - **Energy and Environment:** This segment contributed SGD1.0bn to KEP's 1Q2021 revenue. Revenue from KOM was SGD412mn, lower y/y due to termination of rigs by Awilco Drilling Plc. As at 31 March 2021, the net orderbook for KOM was SGD3.0bn, bulk attributable to gas solutions and renewables. Keppel Infrastructure's revenue was SGD635mn, lower by 2.5% y/y with reported EBITDA of SGD31mn in 1Q2021. The Integrated Waste Management Facility project in Hong Kong is ~29% completed (any target completion timeline) while the Tuas Nexus Integrated Waste Management Facility project is ~7% completed (any target completion timeline).

    - **Urban Development:** Urban Development contributed revenue of SGD510mn in 1Q2021. Keppel Land performed better y/y driven by higher contribution from property trading projects at China and Vietnam and divestment gains.

    - **Connectivity:** This segment contributed SGD294mn of revenue to KEP in 1Q2021. The M1 business saw EBITDA fall to SGD55mn in 1Q2021 versus SGD73mn in 1Q2020 mainly from lower roaming and prepaid revenues. In March 2021, KEP announced that it will invest in the Bifrost Cable System. A binding term sheet has been signed with a fibre broadband provider based in the Philippines, where this customer has the right of use for one fibre pair on the main trunk of the cable system. Per KEP, the company will de-risk the project by signing up with more customers while the project is being built.

    - **Asset Management:** Asset management fees was higher at SGD42mn for 1Q2021 versus SGD35mn in 1Q2020. During the quarter, Keppel Capital launched a China logistics property fund and also obtained a separate account mandate in relation to commercial real estate opportunities in Japan, China and Singapore. As at 31 December 2020, the asset under management ("AUM") was reported at SGD37bn, growing from SGD33bn as at 31 December 2019.

- **Splitting KOM into three divisions:** Since the reaffirmation of KEP's Vision 2030, KEP has announced a number of corporate actions. One of the biggest announcement's year to date is the restructuring of KOM. While equity investors were hopeful for a spin-off of KOM (with KOM combining with Sembcorp Marine Ltd), KEP had announced a more organic plan where KOM will be restructured into three divisions, namely (1) An asset company ("Rig Co") which will hold completed and uncompleted rig assets (2) A company that will hold and progress uncompleted rigs to completion ("Development Co") and (3) An Operating Company ("Op Co") which will comprise the rest of KOM. The book value assets for KOM as at 31 December 2020 was SGD8.8bn while ~SGD2.9bn of completed and uncompleted rigs will be held by Rig Co and Development Co. Per management, net funding of SGD500mn will be required mainly for Development Co to complete the rigs under development. As yet, it was not disclosed how the liabilities at KOM (31 December 2020: SGD9.4bn) will be allocated across the three divisions and it is still unknown how much debt will remain at Op Co. That being said, KEP still fully owns KOM as of writing, with the debt consolidated on its balance sheet.

- **KEP not exiting the offshore & marine business in totality:** In April 2021, the company shared that it is in advanced negotiations on a floating production storage and offloading ("FPSO") project with Petróleo Brasileiro S.A. ("Petrobras", majority owned by the Brazilian government). If KOM wins this project, net orderbook may double. Per management, the intention is for the project to be structured with progress payments though we think this would still entail higher working capital requirements for the KOM business. KEP aims to exit the rig business in the medium term with Rig Co and Development Co being transient parts of KOM. The Op Co will transition into a developer and integrator, focusing on design, engineering and procurement catering to the renewable energy and LNG sector and exit lower value businesses. While KEP executes on its organic plan, it will continue to explore the possibility of inorganic options for the rigs business. While this more organic plan may not immediately stem losses at KEP, we are heartened that the company is taking steps to contain the issues at the rig business. In recent years, this business had faced delivery deferrals, customer cancellations and higher counterparty credit risk from the weakening of credit profiles among customers.

- **Updates on Floatel and KrisEnergy:** Similar to many other SGD bond issuers, the full set of financial results were not provided for 1Q2021. It was unlikely that impairments on KrisEnergy Ltd ("KrisEnergy") were taken during that quarter given that finalization of recovery value of the Aspara Oil Field was still ongoing. Floatel was also undergoing a separate restructuring process for much of 1Q2021.

  (1) KrisEnergy: On 20 April 2021, KrisEnergy (40%-owned by KEP) provided an update that the company's restructuring plan was no longer viable. KrisEnergy announced that based on preliminary analysis, five of its development wells at the Aspara Oil Field appeared less productive than initially forecast. On 28 April 2021, KrisEnergy further updated the market that it received the independent review of the Aspara Oil Field's performance. The third-party petroleum engineering consultant concluded that estimated ultimate recovery from the wells is likely a small fraction of the pre-development estimates. KEP is economically exposed to a revolving credit facility which a bank has extended to KrisEnergy. We expect that KEP will need to "make-whole" the bank. As at 31 December 2020, the outstanding principal was ~SGD247mn. This was an off-balance sheet item as at end-2020 and we think this was also the case as at 31 March 2021. KEP has written-down fully the equity stake it holds in KrisEnergy. However, KEP is also a lender to KrisEnergy via its holdings of the KRISSP 0% '24s (carrying value of ~SGD35mn) and a project financing facility with a security package. This project financing facility is for up to USD87mn (~SGD116mn) though as at 31 December 2020, USD57.7mn (~SGD77mn) has already been drawn down. KEP also has contract assets of SGD29mn attributable to KrisEnergy. Our base case assumes a liquidation at KrisEnergy, and that a cash outflow of SGD247mn will need to be paid by KEP to the bank, with a non-cash impairment ranging from SGD141mn to SGD181mn.

  (2) **Floatel:** Through KOM, KEP owns a ~49.9%-stake in Floatel International Ltd ("Floatel"), whose liquidity had been hampered, resulting in a debt restructuring. In 1Q2021, Floatel reached an agreement with his creditors, with Floatel taking up a new super senior revolving facility with principal amount of up to USD100mn (~SGD132mn). Temasek-owned Clifford Capital Pte Ltd ("Clifford Capital") is the lender of the facility although KOM has entered into a participation agreement where KOM may be required to "make whole" Clifford Capital for any loss that Clifford Capital suffers under the facility. As at 31 December 2020, KEP's carrying value for Floatel was SGD96mn though this has been uplifted to ~SGD284mn as restructuring gains were

recorded at Floatel. In our view, there are still significant uncertainties surrounding the business until a successful turnaround, notwithstanding the change in carrying value and potential boost to 1H2021 and 2021's net profit. (from share of results of associated companies).

- **Attempting to assess EBITDA:** KEP's 2020 financials, especially for 1H2020 was heavily affected by impairments. KEP reported SGD952mn of impairments in 2020 including share of Floatel's impairment of vessels. KEP's reported EBITDA (excluding impairments) for full year 2020 was SGD1.2bn, SGD754mn attributable to 1H2020 and hence implying that for 2H2020, KEP's reported EBITDA (excluding impairments) would have been SGD467mn. We have attempted to remove impairments and one-off items (particularly if these were non-cash as well) from our adjusted EBITDA calculation. Based on our calculation, we find adjusted EBITDA at SGD300.8mn for 2H2020 and SGD689.4mn for the full year 2020 (down 35% y/y). We find resultant adjusted EBITDA/Interest for 2H2020 at 2.2x versus 2.5x in 1H2020. We find total debt (including liabilities)-to-adjusted EBITDA at 18.3x for 2020 (2019: 10.9x). It is worth noting that KEP sells assets and projects as part of its normal course of business in its property trading and township business (held under the Urban Development segment). This means that while some of the gains have been taken out from our adjusted EBITDA numbers, these contribute to overall cash flow generation via cash inflow from investing activities (albeit lumpy).

- **Unadjusted net gearing temporarily declined:** KEP reported an unadjusted net gearing as at 31 March 2021 of 0.88x (31 December 2020: 0.91x). In September 2020, KEP announced that it has identified SGD17.5bn of assets for sale (not including its shipyards and units in REITs and trusts, that can be sold down progressively overtime). SGD3bn to 5bn was targeted to be monetised in the next three years. Excluding the rig assets at KOM, we estimate that more than SGD1.8bn of divestments has already been announced since October 2020, including last week's announcement where M1's mobile, fixed and fibre assets are proposed to be sold into a special purpose vehicle ("SPV") for cash consideration of SGD580mn, with KDC REIT as an investor. KEP is also in the midst of selling Keppel Bay Tower, located at Harbourfront, to KREIT. The total acquisition cost to KREIT is ~SGD667mn where KEP will receive SGD601mn as cash consideration and an additional SGD50.5mn in the form of settling an intercompany loan on the completion date (targeting 2Q2021). While KEP's unadjusted net gearing levels will fall as assets are divested, this is expected to only be temporary as the cash received is targeted to be redeployed towards new growth areas, rather than paying down debt. For example, in December 2020, KEP entered into an agreement to buy a 45%-stake in Harlin Solar Pty Ltd ("Harlin"), to develop and manage the construction and operation of a greenfield solar farm in Australia. KEP also has options to buy the remaining 55%-stake in Harlin. While the upfront equity stake and loan provision is minimal, the project's scale is significant, with expected capacity of at least 500MW. Simplistically, if we assume AUD1.5mn per MW, total project cost may be AUD750mn (~SGD769mn).

- **Possible off-balance sheet debt and debt-like items at M1:** While M1 will hold 100%-stake of the SPV, the transaction in our view may still be structured such that KEP does not need to consolidate the assets and SGD493mn of debt to be taken by the SPV. However, even assuming no consolidation, M1 will be required to make cash payments for the right to use the assets over a 15Y period, which is akin to a financing arrangement (where the sum of these payments are "debt-like"). Earlier in April 2020, a StarHub Ltd ("StarHub", Issuer profile: Neutral (3)) and M1 joint venture successfully won joint rights to operate one of the two 5G networks in Singapore. As we opined in August 2020, while debt assumed by the 50:50 joint venture is unlikely to be consolidated at KEP, banking access would need to cater to the 5G needs. Based on M1 contributing less than ~SGD200mn and Starhub's guidance of SGD200mn in investments, we estimate the total project cost at SGD2.7bn for this multi-year period expenditure. We assume a combined SGD400mn as the equity portion, with the joint venture slated to be 85% debt-funded while 15% would come from equity. In this scenario, the total debt is SGD2.3bn, with M1's proportionate debt at ~SGD1.1bn. KEP owns an effective ~84%-stake in M1, with the remaining stake held by Singapore Press Holdings. Given the project nature, 5G debt may still be able to be structured on a limited or non-recourse basis.

- **Some financial capacity reduction although access to markets remain:** As at 31 December 2020, short term debt at KEP (including lease liabilities) was SGD4.5bn, representing 36% of total debt, and lower than the SGD5.5bn of short term debt due in end-June 2020. Secured debt as a percentage of tangible asset has stayed at ~4.2%. As at 31 December 2020, available credit facilities were SGD5.8bn, lower than the SGD7.8bn that was available in end-2019. In our view, part of the difference was due to debt drawdown to bulk up cash balance (cash of SGD2.5bn in end-2020 versus SGD1.8bn in end-2019), although available facilities had also declined y/y. KEP continues to maintain access to debt capital markets in multiple currencies. Aside from one tranche of USD and one tranche of SGD bonds priced in 2020, KEP tapped the JPY bond market where the company raised JPY8bn (~SGD104mn) in September 2020 at 0.88% in JPY terms.

- **Capital commitments significant:** As at 31 December 2020, KEP faced SGD2.8bn of capital commitments vis-à-vis SGD1.4bn in end-2019 and end-2018. Out of the SGD2.8bn, SGD1.2bn is attributable to commitments for the private funds. One key strategy under Vision 2030 is for KEP to mobilise the asset management business to seek outside investors that will invest in KEP's ongoing projects such as the Gimi Floating Liquefaction Vessel. What this means is that while KEP does not need to bear the whole project cost, we should continue to see a capital tilt towards the private funds business (43% in end-2020 versus ~26-27% previously). Given that the new funds being rolled out at the asset management business include alternative asset and infrastructure classes, we expect that the percentage seed capital or contribution that KEP would need to put in to be higher than traditional real estate funds. As at 31 December 2020, SGD931.7mn of capital commitments is attributable to the purchase and construction of investment properties.

- **Update on the administrative enforcement procedure:** As part of the applicable fines payable under the global resolution, USD52.8mn (~SGD70mn) (less any penalties that KOM may need to pay to specified Brazilian authorities) was payable to a Singapore authority. The payment period has been extended until 22 December 2021 and the discussions with the specified Brazilian authorities remain ongoing. Per KEP's disclosures, the company understands from the Office of the Comptroller General of Brazil ("CGU") that the administrative enforcement procedure will not affect ongoing negotiations with the Brazilian authorities and that the administrative enforcement procedure has been suspended, pending the ongoing discussions. No additional provisions have been made beyond the SGD71mn.

- **From a conglomerate to an integrated company:** Under Vision 2030, KEP emphasized that it is pulling business activities together in an operationally integrated manner, with the changes being communicated to the broader market. KEP now reports its segmental information based on four business segments, Energy & Environment, Urban Development, Connectivity and Asset Management.

Figure 1: Business segments

Energy & Environment	Urban Development	Connectivity	Asset Management
KOM Keppel Infrastructure Keppel Renewable Energy KrisEnergy	Keppel Land Keppel Urban Solutions Sino-Singapore Tianjin Eco-city	M1 Ltd Keppel Data Centres Keppel Logistics[1]	Keppel Capital Private funds Stakes in listed REITs & trusts (KDC REIT, KREIT and KIT)

Source: Company presentation for 2H2020
Note: (1) Parts of the logistics business is in the midst of being sold

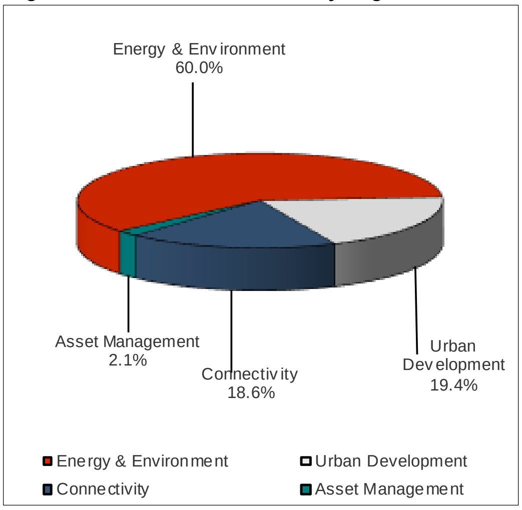
Keppel Corp Ltd

Table 1: Summary Financials

Year End 31st Dec	FY2018	FY2019	FY2020
Income Statement (SGD'mn)			
Revenue	5,964.8	7,579.7	6,574.3
EBITDA	789.3	1,149.9	863.0
EBIT	606.9	774.6	449.5
Gross interest expense	198.4	312.7	292.3
Profit Before Tax	1,239.9	953.5	-254.7
Net profit	956.1	761.1	-508.1
Balance Sheet (SGD'mn)			
Cash and bank deposits	1,981.4	1,783.5	2,479.7
Total assets	26,606.3	31,321.6	32,105.9
Gross debt	7,548.5	11,657.1	12,603.1
Short term debt	1,480.8	4,622.6	4,502.0
Net debt	5,567.1	9,873.6	10,123.4
Shareholders' equity	11,587.1	11,646.0	11,155.9
Cash Flow (SGD'mn)			
CFO	168.9	-706.9	455.7
Capex	254.5	516.8	487.6
Acquisitions	403.9	1,795.6	743.6
Disposals	1,270.5	149.3	653.1
Dividend	546.5	429.6	297.4
Free Cash Flow (FCF)	-85.6	-1,223.6	-32.0
Key Ratios			
EBITDA margin (%)	13.23	15.17	13.13
Net margin (%)	16.03	10.04	-7.73
Gross debt to EBITDA (x)	9.56	10.14	14.60
Net debt to EBITDA (x)	7.05	8.59	11.73
Gross Debt to Equity (x)	0.65	1.00	1.13
Net Debt to Equity (x)	0.48	0.85	0.91
Gross debt/total assets (x)	0.28	0.37	0.39
Net debt/total assets (x)	0.21	0.32	0.32
Cash/current borrowings (x)	1.34	0.39	0.55
EBITDA/Total Interest (x)	3.98	3.68	2.95

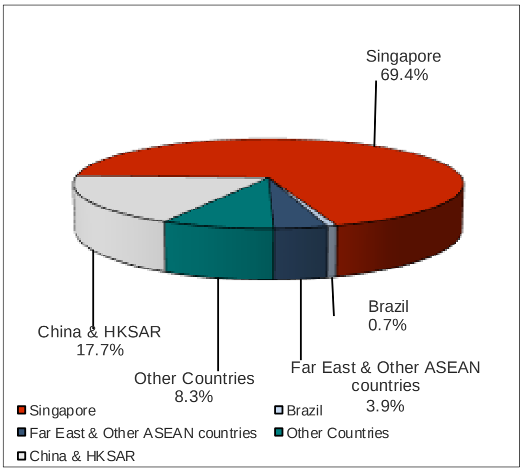
Source: Company, OCBC estimates

Figure 1: Revenue breakdown by Segment - FY2020



Source: Company

Figure 2: Revenue breakdown by Geography - FY2020



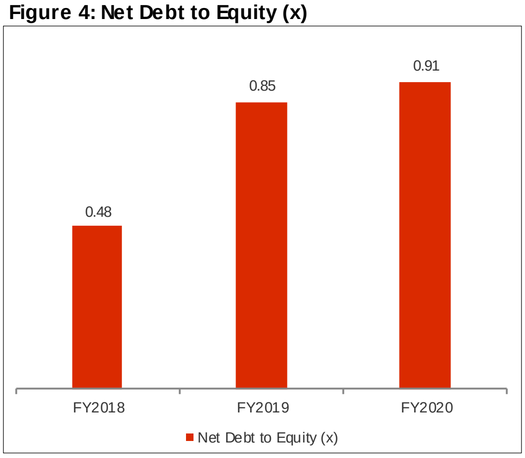
Source: Company

Figure 3: Debt Maturity Profile

Amounts in (SGD'mn)	As at 31/12/2020	% of debt
.		
Amount repayable in one year or less, or on demand		
Secured	179.9	1.4%
Unsecured	4,322.1	34.3%
	4,502.0	**35.7%**
Amount repayable after a year		
Secured	1,090.7	8.7%
Unsecured	7,010.4	55.6%
	8,101.1	**64.3%**
Total	**12,603.1**	**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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Analyst Declaration
The analyst(s) who wrote this report and/or her or his respective connected persons did not hold financial interests in the above-mentioned issuer or company as at the time of the publication of this report.

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