

# Singapore Company Focus

# Keppel Corporation

Bloomberg: KEP SP | Reuters: KPLM.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

23 Oct 2015

## HOLD

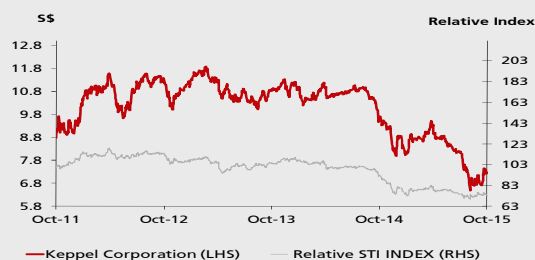
Last Traded Price: S\$7.29 (STI : 3,038.11)  
Price Target : S\$7.40 (1% upside) (Prev S\$7.50)

**Reason for Report :** 3Q15 results, briefing takeaways  
**Potential Catalyst:** Order wins, oil price recovery  
**Where we differ:** We are more bearish on FY16-17 earnings on lower order win assumptions and margins

### Analyst

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### Price Relative



### Forecasts and Valuation

FY Dec (\$m)	2014A	2015F	2016F	2017F
Revenue	13,283	10,206	8,905	9,361
EBITDA	3,155	2,151	2,008	2,108
Pre-tax Profit	2,889	1,873	1,603	1,663
Net Profit	1,885	1,461	1,244	1,291
Net Pft (Pre Ex.)	1,444	1,222	1,244	1,291
EPS (S cts)	104	80.4	68.4	71.0
EPS Pre Ex. (S cts)	79.4	67.2	68.4	71.0
EPS Gth (%)	2	(22)	(15)	4
EPS Gth Pre Ex (%)	2	(15)	2	4
Diluted EPS (S cts)	103	80.1	68.2	70.8
Net DPS (S cts)	47.9	40.2	34.2	35.5
BV Per Share (S cts)	571	604	632	669
PE (X)	7.0	9.1	10.7	10.3
PE Pre Ex. (X)	9.2	10.8	10.7	10.3
P/Cash Flow (X)	608.3	nm	14.3	13.9
EV/EBITDA (X)	6.0	9.7	10.5	10.1
Net Div Yield (%)	6.6	5.5	4.7	4.9
P/Book Value (X)	1.3	1.2	1.2	1.1
Net Debt/Equity (X)	0.1	0.5	0.5	0.5
ROAE (%)	18.8	13.7	11.1	10.9
<b>Earnings Rev (%) :</b>		(1)	(11)	-
<b>Consensus EPS (S cts) :</b>		79.9	79.4	78.6
<b>Other Broker Recs :</b>		B: 8	S: 3	H: 14

ICB Industry : Oil & Gas

ICB Sector: Oil Equipment; Services & Dist

**Principal Business:** Diversified conglomerate with core businesses in offshore marine, property investments and development and infrastructure-based activities.

Source of all data: Company, DBS Bank, Bloomberg Finance L.P.

## Benefits of diversification

- **3Q15 in line; weaker O&M earnings mitigated by stellar property performance**
- **Another three jackup rigs are deferred by 3-4 months with compensation from customers.**

- **HOLD for decent dividend yield; TP adjusted to S\$7.40**  
**3Q15 results demonstrated resiliency of a diversified business.**

Keppel reported net earnings of S\$363m in 3Q15, bringing 9M15 bottomline to S\$1.1bn, which made up c.76% of our full-year estimates. O&M PATMI dropped 34% y-o-y and 4% q-o-q to S\$166m due to a decline in revenue from project deferrals and margin contraction of 2.7ppts to 12%. Infrastructure segment was also weaker, with net contribution falling 11% to S\$34m given the lower contribution from Merlimau Cogen plant after injecting a 51% stake to KIT, and disposal of Keppel FMC. Property segment was the silver lining, registering earnings growth of 57% y-o-y and 24% q-o-q to S\$144m, led by promising overseas property sales predominantly in China and Vietnam and an increase in its stake in Keppel Land.

**Key takeaways from briefing:** 1) Management is cautious as the operating environment remains **challenging** in view of the macro headwinds and low oil prices; 2) **Order book** dwindled from S\$11bn as of end-Jun to S\$10bn as YTD wins have been slow at S\$1.7bn; 3) Keppel accepted requests from Grupo R and Parden to **defer delivery** of three jackup rigs by 3-4 months with some compensation; 4) negotiations with **Sete Brasil** are still ongoing. Construction progress has slowed down pending Sete Brasil's restructuring; 5) **FLNG** remains a bright spot for Keppel. Notice to commence work for the second unit is expected by the end of the year while FEED study for the third unit is advancing. Golar has also initiated talks with Keppel for a potential new contract for a fourth FLNG vessel.

**Maintain HOLD; TP S\$7.40.** We have trimmed our FY16F earnings by 11% after cutting 2015 order wins by S\$500m to S\$2bn and pushed back the commencement of the remaining three Petrobras rigs by another 6 months. While we remain cautious on the rigbuilding outlook in anticipation of sluggish order flow and prevailing deferral and cancellation risks, Keppel's valuation is inexpensive, with the stock trading near its GFC low of 1.1x P/Bv and offering decent dividend yield of 5%. Maintain HOLD. Upside surprise could come from gains from disposals.

### At A Glance

Issued Capital (m shrs)	1,811
Mkt. Cap (S\$m/US\$m)	13,202 / 9,469
Major Shareholders	
Temasek Holdings Pte Ltd (%)	21.0
Blackrock (%)	6.0
Aberdeen (%)	6.0
Free Float (%)	66.3
3m Avg. Daily Val (US\$m)	32.8

## INVESTMENT THESIS

Profile	Rationale
<p>Keppel is a diversified conglomerate with its core businesses in offshore marine (O&amp;M), property investments and development, and infrastructure-based activities in Singapore and the region. O&amp;M is the largest segment that typically contributes about two-thirds of group revenue. It possesses strong market leadership positions in rigbuilding, particularly for jackups and semi-submersibles, FPSO conversion, FLNG conversion, repair and construction of high-end specialised vessels.</p>	<p><b>HOLD for decent dividend yield and potential value-unlocking corporate actions.</b> Keppel remains committed on paying out 50% of its earnings to shareholders. Although DPS could moderate with a potential decline in earnings, yields remain fairly attractive at 5% based on our forecasts. Upside surprises could come from gains from disposal / divestments. In addition, infrastructure should recover with the delivery of all EPC contracts, mitigating the weakness from O&amp;M.</p> <p><b>Offshore &amp; Marine business weighing the group down.</b> Order wins in 9M2015 stood at S\$1.6bn, less than half of 9M14's S\$3.6bn and considerably lower than FY12's and FY13's full-year wins of ~S\$10.0bn. Keppel O&amp;M's net orderbook is shrinking, implying declining top-line and earnings ahead. In 3Q15, O&amp;M PATMI dropped 34% y-o-y and 4% q-o-q to S\$166m due to a drop in revenue from project deferrals, and margin contraction of 2.7ppts to 12%.</p> <p><b>Property business is a mixed bag; infrastructure should bottom out.</b> Singapore home sales remain subdued, but the Chinese market seems to be picking up. Overall, Keppel sold over 3,130 homes in 9M15, with more than 70% from China alone, marking an improvement over the total of 2,400 sold in FY14. For infrastructure, with the handover of both phases of the Greater Manchester EPC project and the Doha North sewage treatment project having incurred its final provision of just under S\$200m in 2Q15, Keppel Infrastructure should see its profitability improve thereafter.</p>
Valuation	Risks
<p>Our TP of S\$7.40 is based on sum-of-parts : (1) O&amp;M segment is valued at 10x price-to-earnings (PE) ratio on FY16 earnings, (2) infrastructure is valued at 10x PE on FY16 earnings, (3) Property segment is valued at 0.8x P/BV, and (4) market values/estimated fair values are used for listed subsidiaries.</p>	<p><b>Competition from foreign yards.</b> Keener competition from Chinese yards, which are usually aggressive in their pricing and lax with payment terms, as well as Korean peers, may affect order wins and profitability, especially if Keppel starts to offer concessions to protect market share.</p> <p><b>Further deferrals possible if oil prices remain subdued.</b> Since the oil price started declining in mid-2014, we have seen oil majors and asset owners slash capex spending substantially, which has hit the yards hard. Meanwhile, deliveries of newbuilds and conversions already under construction are being delayed – a situation which could worsen if oil prices remain low.</p>

Source: DBS Bank

## SOTP-based target price for Keppel

	Value (S\$ m)	Metrics
<b>Market value of listed entities</b>	<b>1,141</b>	
Less: book value	757	
<b>Surplus from listed associates (1)</b>	<b>384</b>	
Surplus - Property (2)	(924)	Surplus from Keppel Land, Keppel Harbour site, using ASP of S\$1,500psf
Surplus - Offshore/Marine (3)	5,742	10x FY16 net profit, less book value
Surplus - Infrastructure (4)	(584)	10x FY16 net profit, less book value
<b>Net Surplus (Listed and unlisted entities) (1+2+3+4 )</b>	<b>4,618</b>	
Add: Book value (less minorities) as of end FY13	10,381	
<b>RNAV</b>	<b>14,999</b>	
RNAV per share (S\$)	8.22	
<b>Fair value for KEP (S\$)</b>	<b>7.40</b>	10% conglomerate discount

Source: Company, DBS Bank

## Keppel Corporation

## Key Assumptions

FY Dec	2013A	2014A	2015F	2016F	2017F
O&M order wins (\$\$ m)	6,754	4,974	2,000	3,000	3,000

## Segmental Breakdown

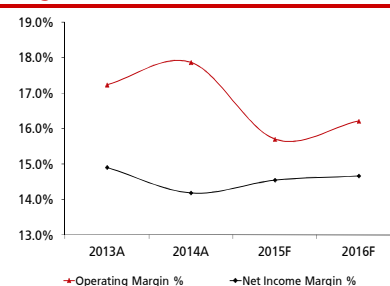
FY Dec	2013A	2014A	2015F	2016F	2017F
<b>Revenues (\$\$m)</b>					
Offshore and Marine	7,126	8,556	6,445	5,721	6,025
Property	1,768	1,729	1,625	1,761	1,933
Infrastructure	3,459	2,933	2,073	1,351	1,332
Investments	27.2	64.0	63.3	71.9	70.7
<b>Total</b>	<b>12,380</b>	<b>13,283</b>	<b>10,206</b>	<b>8,905</b>	<b>9,361</b>
<b>EBIT (\$\$m)</b>					
Offshore and Marine	1,059	1,224	874	788	846
Property	981	667	467	437	456
Infrastructure	69.2	466	249	216	226
Investments	17.5	18.2	15.8	18.0	17.7
Others	7.26	0.0	0.0	0.0	0.0
<b>Total</b>	<b>2,134</b>	<b>2,375</b>	<b>1,606</b>	<b>1,459</b>	<b>1,546</b>
<b>EBIT Margins (%)</b>					
Offshore and Marine	14.9	14.3	13.6	13.8	14.0
Property	55.5	38.6	28.7	24.8	23.6
Infrastructure	2.0	15.9	12.0	16.0	17.0
Investments	64.3	28.4	25.0	25.0	25.0
<b>Total</b>	<b>17.2</b>	<b>17.9</b>	<b>15.7</b>	<b>16.4</b>	<b>16.5</b>

## Income Statement (\$\$m)

FY Dec	2013A	2014A	2015F	2016F	2017F
Revenue	12,380	13,283	10,206	8,905	9,361
Cost of Goods Sold	(8,604)	(9,245)	(6,661)	(5,718)	(5,999)
<b>Gross Profit</b>	<b>3,777</b>	<b>4,038</b>	<b>3,545</b>	<b>3,186</b>	<b>3,362</b>
Other Opng (Exp)/Inc	(1,642)	(1,665)	(1,939)	(1,728)	(1,816)
<b>Operating Profit</b>	<b>2,134</b>	<b>2,373</b>	<b>1,606</b>	<b>1,459</b>	<b>1,546</b>
Other Non Opg (Exp)/Inc	14.0	11.9	10.2	8.90	9.36
Associates & JV Inc	626	504	300	300	300
Net Interest (Exp)/Inc	19.5	(0.9)	(43.6)	(165)	(192)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
<b>Pre-tax Profit</b>	<b>2,794</b>	<b>2,889</b>	<b>1,873</b>	<b>1,603</b>	<b>1,663</b>
Tax	(397)	(462)	(318)	(273)	(283)
Minority Interest	(551)	(541)	(93.3)	(86.5)	(89.7)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
<b>Net Profit</b>	<b>1,846</b>	<b>1,885</b>	<b>1,461</b>	<b>1,244</b>	<b>1,291</b>
Net Profit before Except.	1,412	1,444	1,222	1,244	1,291
EBITDA	3,017	3,155	2,151	2,008	2,108
<b>Growth</b>					
Revenue Gth (%)	(11.3)	7.3	(23.2)	(12.7)	5.1
EBITDA Gth (%)	(12.3)	4.6	(31.8)	(6.6)	5.0
Opg Profit Gth (%)	(18.6)	11.2	(32.3)	(9.2)	6.0
Net Profit Gth (Pre-ex) (%)	(26.2)	2.3	(15.4)	1.8	3.8
<b>Margins &amp; Ratio</b>					
Gross Margins (%)	30.5	30.4	34.7	35.8	35.9
Opg Profit Margin (%)	17.2	17.9	15.7	16.4	16.5
Net Profit Margin (%)	14.9	14.2	14.3	14.0	13.8
ROAE (%)	19.5	18.8	13.7	11.1	10.9
ROA (%)	6.2	6.1	4.8	4.3	4.4
ROCE (%)	8.6	9.1	6.2	5.8	6.0
Div Payout Ratio (%)	39.2	46.2	50.0	50.0	50.0
Net Interest Cover (x)	NM	2,579.8	36.8	8.9	8.1

Source: Company, DBS Bank

## Margins Trend



## Quarterly / Interim Income Statement (\$m)

FY Dec	3Q2014	4Q2014	1Q2015	2Q2015	3Q2015
Revenue	3,185	3,925	2,814	2,563	2,440
Cost of Goods Sold	(2,239)	(2,803)	(1,803)	(1,920)	(1,535)
<b>Gross Profit</b>	<b>946</b>	<b>1,122</b>	<b>1,011</b>	<b>643</b>	<b>904</b>
Other Oper. (Exp)/Inc	(381)	(196)	(613)	(229)	(534)
<b>Operating Profit</b>	<b>565</b>	<b>926</b>	<b>398</b>	<b>414</b>	<b>370</b>
Other Non Opg (Exp)/Inc	6.52	3.77	1.22	4.75	7.01
Associates & JV Inc	61.6	255	61.2	90.2	101
Net Interest (Exp)/Inc	9.16	(23.8)	(5.2)	(11.3)	(9.6)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
<b>Pre-tax Profit</b>	<b>643</b>	<b>1,161</b>	<b>455</b>	<b>498</b>	<b>469</b>
Tax	(105)	(136)	(81.3)	(88.0)	(97.0)
Minority Interest	(123)	(299)	(13.9)	(13.1)	(9.5)
<b>Net Profit</b>	<b>414</b>	<b>726</b>	<b>360</b>	<b>397</b>	<b>363</b>
Net profit bef Except.	342	382	357	160	363
EBITDA	701	1,254	526	574	534

## Growth

Revenue Gth (%)	0.3	23.3	(28.3)	(8.9)	(4.8)
EBITDA Gth (%)	7.0	78.9	(58.0)	9.0	(6.9)
Opg Profit Gth (%)	21.0	63.8	(57.0)	4.0	(10.6)
Net Profit Gth (Pre-ex) (%)	(11.2)	11.6	(6.3)	(55.2)	126.6

## Margins

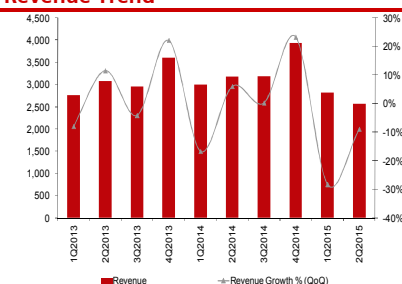
Gross Margins (%)	29.7	28.6	35.9	25.1	37.1
Opg Profit Margins (%)	17.7	23.6	14.2	16.2	15.2
Net Profit Margins (%)	13.0	18.5	12.8	15.5	14.9

## Balance Sheet (\$m)

FY Dec	2013A	2014A	2015F	2016F	2017F
Net Fixed Assets	3,798	2,673	2,788	2,898	2,995
Invts in Associates & JVs	5,482	4,988	5,238	5,486	5,732
Other LT Assets	2,818	2,706	2,706	2,706	2,706
Cash & ST Invts	6,010	6,107	1,623	1,522	1,555
Inventory	8,995	10,681	11,339	11,131	11,702
Debtors	1,916	2,510	3,402	2,968	3,120
Other Current Assets	1,037	1,889	1,889	1,889	1,889
<b>Total Assets</b>	<b>30,056</b>	<b>31,555</b>	<b>28,986</b>	<b>28,601</b>	<b>29,700</b>
ST Debt	517	1,796	1,796	1,796	1,796
Creditor	5,409	5,581	5,670	4,947	5,201
Other Current Liab	3,416	3,597	2,756	2,493	2,580
LT Debt	6,583	5,587	6,287	6,287	6,287
Other LT Liabilities	442	266	266	266	266
Shareholder's Equity	9,701	10,381	10,971	11,485	12,154
Minority Interests	3,988	4,347	1,240	1,327	1,416
<b>Total Cap. &amp; Liab.</b>	<b>30,056</b>	<b>31,555</b>	<b>28,986</b>	<b>28,601</b>	<b>29,700</b>
Non-Cash Wkg. Capital	3,123	5,902	8,205	8,548	8,931
Net Cash/(Debt)	(1,090)	(1,275)	(6,460)	(6,560)	(6,528)
Debtors Turn (avg days)	55.4	60.8	105.7	130.6	118.7
Creditors Turn (avg days)	237.4	223.4	319.5	353.7	322.3
Inventory Turn (avg days)	363.5	399.9	625.4	748.6	725.1
Asset Turnover (x)	0.4	0.4	0.3	0.3	0.3
Current Ratio (x)	1.9	1.9	1.8	1.9	1.9
Quick Ratio (x)	0.8	0.8	0.5	0.5	0.5
Net Debt/Equity (X)	0.1	0.1	0.5	0.5	0.5
Net Debt/Equity ex MI (X)	0.1	0.1	0.6	0.6	0.5
Capex to Debt (%)	12.7	(5.1)	4.3	4.3	4.3
Z-Score (X)	2.0	2.1	2.0	2.0	2.0

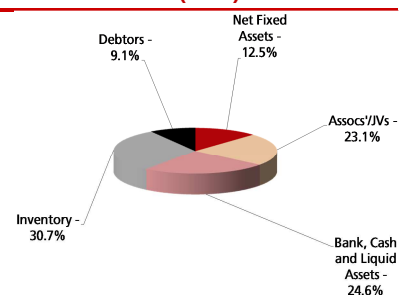
Source: Company, DBS Bank

## Revenue Trend



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## Asset Breakdown (2015)



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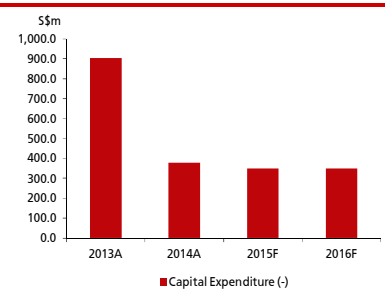
**Keppel Corporation**

**Cash Flow Statement (\$m)**

FY Dec	2013A	2014A	2015F	2016F	2017F
Pre-Tax Profit	2,794	2,889	1,873	1,603	1,663
Dep. & Amort.	242	265	235	240	253
Tax Paid	(585)	(328)	(463)	(318)	(273)
Assoc. & JV Inc/(loss)	(626)	(504)	(300)	(300)	(300)
Chg in Wkg.Cap.	(492)	(340)	(2,159)	(297)	(393)
Other Operating CF	(709)	(1,960)	0.0	0.0	0.0
<b>Net Operating CF</b>	<b>625</b>	<b>21.8</b>	<b>(814)</b>	<b>928</b>	<b>950</b>
Capital Exp.(net)	(903)	379	(350)	(350)	(350)
Other Invt.(net)	0.0	0.0	(3,200)	0.0	0.0
Invt in Assoc. & JV	(473)	231	(150)	(149)	(148)
Div from Assoc & JV	267	410	200	201	202
Other Investing CF	431	(144)	0.0	0.0	0.0
<b>Net Investing CF</b>	<b>(678)</b>	<b>877</b>	<b>(3,500)</b>	<b>(298)</b>	<b>(296)</b>
Div Paid	(843)	(1,029)	(870)	(730)	(622)
Chg in Gross Debt	2,130	272	700	0.0	0.0
Capital Issues	39.8	34.3	0.0	0.0	0.0
Other Financing CF	201	(46.5)	0.0	0.0	0.0
<b>Net Financing CF</b>	<b>1,528</b>	<b>(769)</b>	<b>(170)</b>	<b>(730)</b>	<b>(622)</b>
Currency Adjustments	34.6	42.2	0.0	0.0	0.0
Chg in Cash	1,509	171	(4,484)	(101)	32.4
Opg CFPS (S cts)	61.8	19.9	74.0	67.4	73.9
Free CFPS (S cts)	(15.4)	22.0	(64.0)	31.8	33.0

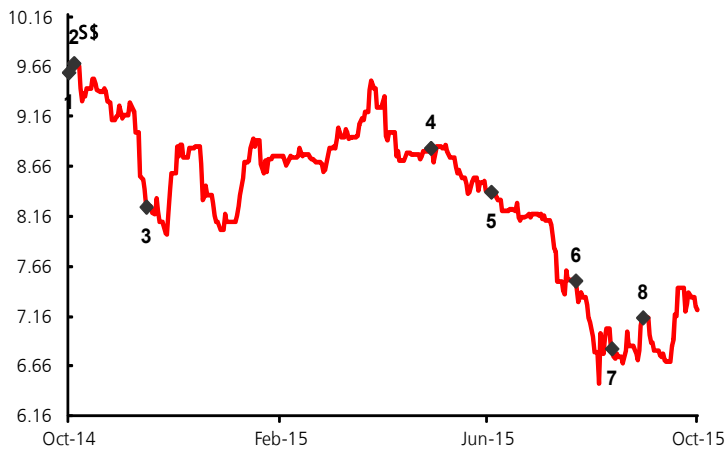
Source: Company, DBS Bank

**Capital Expenditure**



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**Target Price & Ratings History**



Note: Share price and Target price are adjusted for corporate actions.

S.No.	Date	Closing Price	Target Price	Rating
1:	20 Oct 14	9.61	11.10	BUY
2:	23 Oct 14	9.70	11.10	BUY
3:	04 Dec 14	8.26	9.34	BUY
4:	18 May 15	8.85	9.32	BUY
5:	22 Jun 15	8.41	9.32	BUY
6:	10 Aug 15	7.52	8.14	HOLD
7:	31 Aug 15	6.84	7.50	HOLD
8:	18 Sep 15	7.15	7.50	HOLD

Source: DBS Bank

DBS Bank recommendations are based on an Absolute Total Return\* Rating system, defined as follows:

**STRONG BUY** (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

**BUY** (>15% total return over the next 12 months for small caps, >10% for large caps)

**HOLD** (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

**FULLY VALUED** (negative total return i.e. > -10% over the next 12 months)

**SELL** (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

*Share price appreciation + dividends*

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