18 October 2019

Industrials | Offshore & Marine

Keppel Corp (KEP SP)

Buy (Maintained)

Weak 3Q Earnings, O&M Outlook Positive; BUY

Target Price (Return)	SGD7.18 (+20%)
Price:	SGD5.96
Market Cap:	USD7,915.1m
Avg Daily Turnover (SGD/USD)	11.3m/8.2m

- **Maintain BUY with new SGD7.18 TP from SGD7.30, 20% upside plus c.4% yield.** 3Q19 results were below expectations, with 9M19 net profit of SGD515m representing 58% of our pre-results 2019 forecast. However, we are bullish on Keppel Corp, with expectations of improving O&M earnings from a stronger net orderbook – SGD5.1bn from FY18's SGD4.3bn. In the meantime, the property division earnings should support dividend payment.
- **Property division 3Q19 PBT halved YoY (to SGD123m) due to absence of divestment gain** of Beijing Aether and higher net interest expense. However, there was some offsetting effect by higher property trading profits in China and Singapore. The property division remains the largest contributor to 9M19 net profit – at 66% share.
- **Offshore & Marine (O&M) division's 3Q19 revenue surged 52% YoY to SGD632m,** due to higher revenue recognition from ongoing projects. However, O&M PBT was down 20% YoY to SGD8m mainly due to net interest expense (vs 3Q18 net interest income). On a positive note, new contracts secured by Keppel O&M (KOM) YTD amounted to SGD1.9bn, with close to 60% for LNG and renewables-related projects. KOM's settlement agreement with Sete Brasil paves the path for completion of construction of some (or all) of the rigs, which should help drive revenue going forward.
- **Infrastructure division saw 3Q19 datacentre fair value gains**, helping PBT expand 53% to SGD92m. This datacentre investment property – the Keppel DC Singapore 4 – will be divested to Keppel DC REIT (KDCREIT SP, NR).
- **Given the weak 3Q19 earnings, we cut FY19F net profit by 14% to SGD769m.** However, we believe FY20F earnings will recover from improvement in the property and O&M businesses.
- **Valuation – diversified asset structure with huge value unlocking potential.** Keppel has multiple businesses in different industries, and we used SOP methodology for valuation, before arriving at a TP of SGD7.18, based on O&M division valued at 1.4x FY20F P/BV, a premium over the 4-year average 1x P/BV of Sembcorp Marine (SMM SP, BUY, TP: SGD1.63); its infrastructure division valued conservatively at 10x FY20F P/E; and property division valued at 40% discount to RNAV – close to the average discount to RNAV applied for China listed property developers.

Forecasts and Valuation	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover (SGDm)	5,964	5,965	7,477	7,868	8,407
Recurring net profit (SGDm)	196	944	769	1,082	1,149
Recurring net profit gr (%)	(75.0)	381.5	(18.5)	40.7	6.3
Recurring P/E (x)	55.1	11.4	14.0	10.0	9.4
P/BV (x)	0.9	1.0	0.9	0.9	0.8
P/CF (x)	9.0	86.5	(16.6)	7.0	7.7
Dividend Yield (%)	6.2	6.7	3.6	5.0	5.3
EV/EBITDA (x)	16.1	13.4	15.3	13.4	11.9
ROE (%)	1.7	8.3	6.7	9.1	9.0
Net debt to equity (%)	46.1	48.0	68.3	59.5	47.6
Interest coverage (x)	4.2	5.3	4.1	4.7	4.5

Source: Company data, RHB

Analyst

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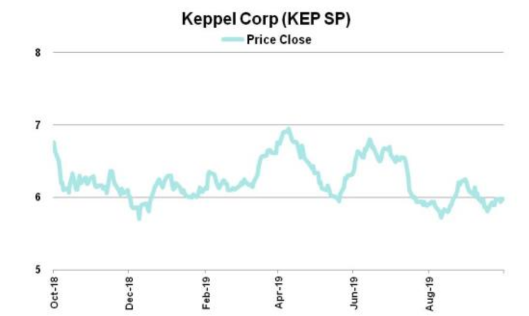
Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	1.0	(4.0)	(10.9)	(11.7)	(11.4)
Relative	(1.0)	(2.3)	(3.9)	(5.1)	(13.3)
52-wk Price low/high (SGD)					5.67 - 6.97



Source: Bloomberg

Financial Exhibits

Asia
Singapore
Offshore & Marine
Keppel Corp
KEP SP
BUY

Valuation basis

SOP methodology

Key drivers

i. Value unlocking through capital recycling;
ii. Improving O&M division outlook.

Key risks

i. Possible slowdown in China property market;
ii. Slowdown in O&M industry.

Company Profile

Keppel Corp is a conglomerate with business interests in property, offshore & marine and infrastructure.

Financial summary	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Recurring EPS (SGD)	0.11	0.52	0.42	0.60	0.63
DPS (SGD)	0.37	0.40	0.21	0.30	0.32
BVPS (SGD)	6.32	6.23	6.38	6.72	7.35
ROE (%)	1.7	8.3	6.7	9.1	9.0

Valuation metrics	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Recurring P/E (x)	55.1	11.4	14.0	10.0	9.4
P/B (x)	0.9	1.0	0.9	0.9	0.8
FCF Yield (%)	7.5	(1.2)	(8.8)	10.9	9.3
Dividend Yield (%)	6.2	6.7	3.6	5.0	5.3
EV/EBITDA (x)	16.1	13.4	15.3	13.4	11.9
EV/EBIT (x)	20.4	15.7	22.5	16.4	14.4

Income statement (SGDm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover	5,964	5,965	7,477	7,868	8,407
Gross profit	979	789	1,158	1,282	1,365
EBITDA	1,013	1,225	1,238	1,367	1,454
Depreciation and amortisation	(212)	(182)	(394)	(250)	(252)
Operating profit	801	1,043	844	1,117	1,202
Net interest	(51)	(34)	(83)	(102)	(126)
Pre-tax profit	441	1,240	965	1,372	1,464
Taxation	(244)	(284)	(182)	(271)	(294)
Net profit	196	944	769	1,082	1,149
Recurring net profit	196	944	769	1,082	1,149

Cash flow (SGDm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Change in working capital	1,101	(183)	(980)	1,231	1,100
Cash flow from operations	1,203	125	(652)	1,543	1,403
Capex	(393)	(255)	(299)	(368)	(397)
Cash flow from investing activities	557	677	(1,340)	(292)	(304)
Dividends paid	(364)	(526)	(460)	(462)	(12)
Cash flow from financing activities	(1,479)	(1,025)	1,590	(941)	48
Cash at beginning of period	2,019	2,241	1,972	1,540	1,823
Net change in cash	281	(223)	(402)	311	1,147
Ending balance cash	2,241	1,972	1,540	1,823	2,943

Balance sheet (SGDm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total cash and equivalents	2,274	1,981	1,540	1,823	2,943
Tangible fixed assets	2,433	2,373	3,316	3,320	3,295
Total investments	9,833	9,556	9,751	10,142	10,586
Total assets	28,686	26,606	28,438	29,219	31,034
Short-term debt	1,714	1,481	2,536	2,340	2,426
Total long-term debt	6,079	6,068	7,123	6,927	7,013
Total liabilities	16,713	15,019	16,548	16,711	17,393
Total equity	11,973	11,587	11,890	12,507	13,641
Total liabilities & equity	28,686	26,606	28,438	29,219	31,034

Key metrics	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Revenue growth (%)	(11.9)	0.0	25.4	5.2	6.9
Recurrent EPS growth (%)	(75.0)	381.5	(18.5)	40.7	6.3
Gross margin (%)	16.4	13.2	15.5	16.3	16.2
Operating EBITDA margin (%)	17.0	20.5	16.6	17.4	17.3
Net profit margin (%)	3.3	15.8	10.3	13.7	13.7
Capex/sales (x)	6.6	4.3	4.0	4.7	4.7
Interest cover (x)	4.2	5.3	4.1	4.7	4.5

Source: Company data, RHB

Figure 1: Quarterly highlights

FYE Dec (SGDm)	1Q18	2Q18	3Q18	1Q19	2Q19	3Q19	YoY%	Comments
Revenue	1,470	1,523	1,296	1,531	1,784	2,067	60	Stronger 3Q19 revenue with all divisions registering higher revenues. Higher recognition from O&M, property & infrastructure projects, as well as increased sales in the power & gas business & from the consolidation of M1's results
Operating EBIT	486	280	282	322	160	184	(35)	3Q19 EBIT fell YoY due to absence of gain from divestment of Beijing Aether
-Offshore marine	8	6	6	3	11	33	438	
-Infrastructure	17	35	43	12	27	50	16	
-Property	462	237	222	172	98	95	(57)	3,250 homes were sold in 9M19, up 12% YoY from stronger China & Vietnam performance
-Investments and others	(1)	2	11	135	24	6	(43)	
Net Profit	337	249	223	203	153	198	(11)	Infrastructure division was the top contributor to 3Q19 Group's earnings
-Offshore marine	(23)	(17)	2	6	4	8	425	
-Infrastructure	26	40	55	16	43	84	53	
-Property	378	228	158	132	130	75	(53)	3Q19 property net profit was weaker YoY due to the absence of en-bloc sales & divestments
-Investments and others	(44)	(2)	8	49	(23)	31	309	
EBIT margin (%)	33	18	22	21	9	9		

Source: Company data, RHB

Figure 2: Keppel's P&L statement

FYE: Dec (SGDm)	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Revenue	**5,964**	**5,965**	**7,477**	**7,868**	**8,407**
-Offshore marine	1,801	1,875	2,100	2,578	2,708
-Infrastructure	2,207	2,629	2,940	3,227	3,540
-Property	1,782	1,340	1,429	1,628	1,710
-Investments and others	173	121	1,008	435	449
Operating EBIT	**801**	**1,043**	**844**	**1,117**	**1,202**
-Offshore marine	(167)	(73)	99	155	176
-Infrastructure	125	105	122	116	128
-Property	668	1,032	453	651	684
-Investments and others	175	(21)	170	195	214
Net profit	**196**	**944**	**769**	**1,082**	**1,149**
-Offshore marine	(826)	(109)	52	101	115
-Infrastructure	134	170	167	170	185
-Property	650	938	482	652	674
-Investments and others	238	(54)	68	158	176
Revenue growth (YoY %)	(11.9)	0.0	25.4	5.2	6.9
Net profit growth (YoY %)	(75.0)	381.5	(18.5)	40.7	6.3
EBIT margin (%)	**13.4**	**17.5**	**11.3**	**14.2**	**14.3**
-Offshore marine	(9.3)	(3.9)	4.7	6.0	6.5
-Infrastructure	5.7	4.0	4.1	3.6	3.6
-Property	37.5	77.0	31.7	40.0	40.0
-Investments and others	101.3	(17.5)	16.9	44.8	47.7
Orderbook b/f (SGDm)		3,900	4,300	5,400	5,622
Orderbook replenishment for period (SGDm)	1,200	1,700	3,300	2,900	3,200
Orderbook utilised over period (SGDm)	2,700	(1,300)	(2,200)	(2,678)	(2,808)
Orderbook c/f (SGDm)	3,900	4,300	5,400	5,622	6,014
Brent period average (USD/bbl)	54.35	71.15	64.00	64.00	60.00

Source: Company data, RHB

Figure 3: Keppel's SOP valuation

Segments	Shares (m)	Stake	Price (SGD)	Value (SGDm)	Value/share (SGD)	Remarks
Offshore & Marine				4,014	2.21	1.4x FY20F P/BV
Infrastructure (1)				1,771	0.98	10x FY20F P/E
Property (2)				6,600	3.63	0.6x FY20F RNAV
Investments						
-Keppel Capital				1,188	0.65	15x FY20F P/E
-Tianjin eco-city		50%		1,200	0.66	Valuation from KCL
-M1		84%		1,579	0.87	SGD2.06/M1 share offer
Total Sum Of Parts				16,352	9.00	No of KEP shares =1816m
Conglomerate discount				20%		
SOTP after discount				13,042	**7.18**	

Note: (1) Keppel T&T is subsumed under Infrastructure, Keppel DC REIT is subsumed under Keppel T&T, Kep Infrastructure Trust is subsumed under Infrastructure
Note 2: (2) KREIT is subsumed under Property
Source: Bloomberg, RHB

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