

# Singapore Industry Focus

## Singapore Rigbuilders

Refer to important disclosures at the end of this report

DBS Group Research . Equity

22 Jan 2018

### New orders drive rerating

- Robust contract wins and positive sector developments drive further re-rating
- Sembcorp Marine (SMM) unlocking value from yard redevelopment?
- Keppel's potential sale of six rigs adds to optimism
- Reiterate BUY on SMM, Sembcorp Industries (SCI) and Keppel with higher TPs

**Rally has legs.** Keppel and SMM have gained 26%/50% since our rating upgrades in July/Feb-2017. We believe the rally has legs, driven by further evidence of sector recovery and contract flows (see table on bottom right). We have raised our O&M valuation peg to 2.4x P/B (0.5SD below mean) in anticipation of order wins of S\$3bn for each in 2018 and lifted our target prices for SMM (S\$3.10 TP), SCI (S\$4.50 TP) and Keppel (S\$10.30 TP). Any potential pullback after recent strong rally of 10-20% presents buying opportunities.

SMM remains our top pick to ride O&G recovery with its strong visible order pipeline; Keppel is a safer bet backed by its multi-pronged business strategy; and SCI could see uplift from a positive strategic review outcome.

**SMM redeveloping Admiralty Yard?** While we see low likelihood of a privatisation of SMM, we do not rule out possibility of a yard merger. ([Shipyards: Creating Global Champions: Time to reform, restructure and reposition](#)). Market talk of SMM redeveloping its huge 87 hectare Admiralty Yard into a waterfront township has resurfaced. Our back-of-envelope calculation shows that the redevelopment of the site could potentially add S\$0.64 - S\$1 to SMM's fair value, assuming a 5-10 years redevelopment period, if it happens. However, we note the large size of the project requires significant capital commitment and SMM lacking the expertise in property development, the certainty of execution at this moment is uncertain.

**Keppel offloading six jackups to Borr.** Keppel is in talks with Borr Drilling on the sale of six jackup rigs. If the rigs are sold at the reported sale value of US\$160m per rig, which implies 25% discount to the original contract value, we do not expect a material impact on the P&L given the 20% downpayment and estimated 5-10% margins. This not only removes a key overhang for Keppel, but also reinforces a growing optimism on rig demand and O&G activity level.

**Key risks.** The collapse in oil prices below US\$50 per barrel (bbl) might defer project FID (Final Investment Decision) and delay capex expansion. Slower than expected contract flows could affect earnings recovery.

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#### STOCKS

	Price S\$	Mkt Cap US\$m	12-mth Target Price S\$	Performance (%)		Rating
				3 mth	12 mth	
Keppel Corporation	8.25	11,327	10.30	13.0	34.2	BUY
Sembcorp Industries	3.39	4,580	4.50	5.3	10.1	BUY
Sembcorp Marine	2.30	3,636	3.10	23.7	56.5	BUY

Source: DBS Bank, Bloomberg Finance L.P.

Closing price as of 19 Jan 2018

#### Potential order wins

Sembcorp Marine		
Type	Potential Customer / Project	Est.value (\$ m)
Modularised LNG Exporting Terminal	Poly-GCL	1,000
Compressed Gas Liquid carriers x2	SeaOne Caribbean	800
Semisub Production Unit	Shell's Vito	400-800
FPSO (topside)	Statoil's Johan Castberg	200-400
Modularised LNG Importing Terminal	-	200-300
FPSO conversion	-	200-300
		<b>2,800-3,600</b>

Keppel O&M		
Type	Potential Customer / Project	Est.value (\$ m)
FPSO conversion x4	Petrobras, Modec and others	600-800
LNG containership x2	Pasha Hawaii	500
Semisub Production Unit	-	300-400
Specialised vessels (LNG carriers, Dredgers) x4	-	200
LNG solutions to remote Islands @ Indonesia	Keppel-Pavilion-PLN	200
FLNG	-	900
		<b>2,700-3,000</b>

Source: Various sources, Company, DBS Bank

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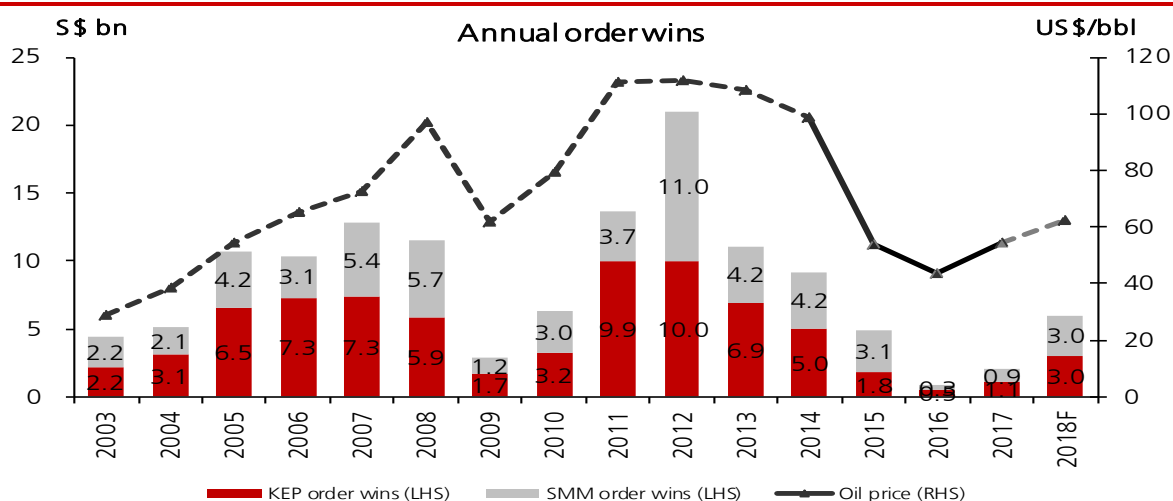
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### Order wins remain leading indicator

**Singapore rigbuilders still among best proxies to oil price.** We would like to reiterate that Singapore rigbuilders' share prices have historically been highly correlated to oil prices with coefficient of 0.9x, even though their earnings are not directly impacted by oil price. Higher oil price is a harbinger for contract flows which is a leading indicator of earnings growth and thus stock performance. The hypothesis remains valid, in our view.

**Order wins trending up.** Contract wins of SMM and Keppel hit a low of S\$300-500m each in 2016 before inching up to approximately S\$1bn each in 2017. While the street had expected stronger order momentum of above S\$1.5bn last year but FID of some projects were pushed back. We expect most of these projects to crystallise in 1H2018 in view of the decent oil price level at above US\$60/bbl, driving this year's contract wins towards our assumption of S\$3bn, with upside potential especially for SMM.

### Order wins vs oil price



\*2012 includes Sete rig orders worth S\$6-7bn for Keppel and SMM respectively.

### SMM: Order wins vs share price



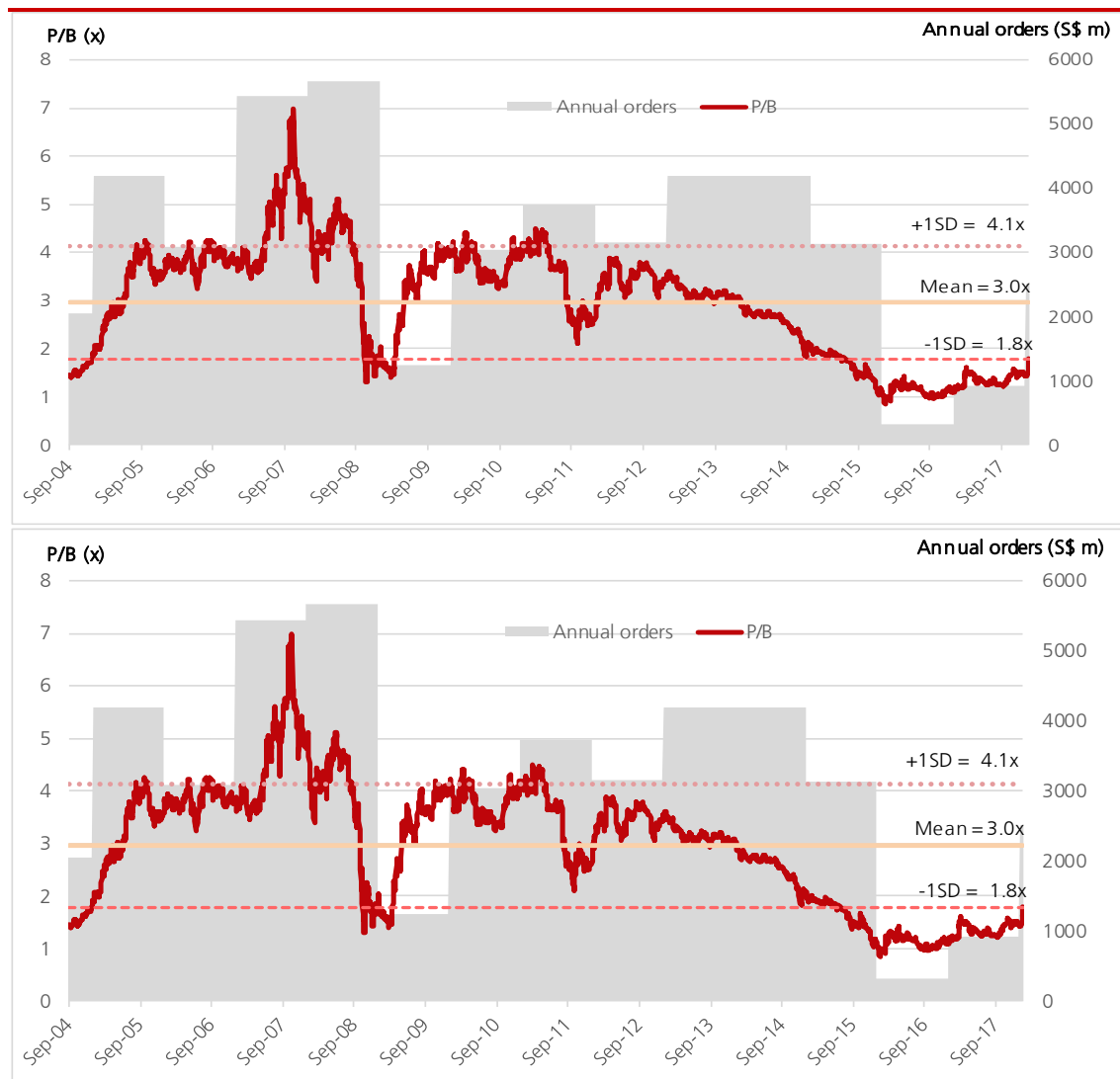
Source: Bloomberg Finance L.P., Companies, DBS Bank

**Rigbuilders to move closer to mean valuation.** P/B valuation is a more appropriate metric to value shipyards during a recovery phase as earnings normally lag by 1-2 years. We benchmark our valuation against SMM which is a pure O&M play. SMM was trading at c.+1SD above mean at 4.1x P/B when order wins exceeded S\$5bn and close to a mean of 3x when S\$3-4bn worth of new orders were secured. We believe as order wins move towards the S\$3bn mark, the stock could trade closer to 2.4x P/B which is 0.5SD below mean.

We acknowledge that contract pricing is likely to be more competitive now and ROE could be lower. Nevertheless, order wins are much needed to improve yard utilisation, and economies of scale, which will drive margin recovery. In addition, Keppel and SMM have already made impairments to their book values during 2015-2017.

**Further re-rating** from this level hinges on 1) Stronger order wins above S\$3bn; 2) Evidence of earnings recovery; and 3) M&A potential.

#### SMM: P/B vs Order Wins vs ROE



Source: Thomson Reuters, Companies, DBS Bank

**Raising our O&M valuation multiple to 2.4x.** We raised our O&M valuation multiple to 1.8x P/B in Jul-2017 with S\$2bn order win expectation. We now expect SMM to secure S\$3bn worth of new orders in 2018 in view of the robust visible pipeline likely to materialise in 1H18. This could drive O&M's valuation to inch

closer to 2.4x P/B, which is 0.5SD below mean of 3.0x P/B. This lifts our target prices for SMM and Keppel to S\$3.10 (from S\$2.30) and S\$10.30 (from S\$9.80) respectively.

#### Sensitivity of target price to P/B multiple

O&M PB	1.8 -1SD	2.4 -0.5SD	3.0 Mean	3.5 +0.5SD	4.1 +1SD
<b>Target Prices</b>					
SMM	2.30	3.10	3.80	4.60	5.40
SCI	4.10	4.50	4.90	5.40	5.90
Keppel	9.80	10.30	10.80	11.30	11.70
<b>% Change</b>					
SMM		+35%			
SCI		+10%			
Keppel		+5%			

Source: Companies, DBS Bank

#### Peer comparisons

Company	Market cap (US\$m)	P/E		EV/EBITDA		P/B	ROE (%)		Net D/E	Div Yld (%)
		FY17F	FY18F	FY17F	FY18F	Current	FY17F	FY18F	Current	Current
Keppel Corp	11,339	18.7x	15.9x	20.3x	17.2x	1.3x	6.8%	7.5%	0.54x	2.4%
Hyundai Heavy Industries	7,171	4.4x	113.8x	12.8x	15.8x	0.7x	13.5%	0.9%	0.33x	N/A
Yangzijiang	4,868	12.4x	13.8x	6.1x	6.4x	1.2x	10.5%	8.8%	CASH	2.5%
Samsung Heavy Industries	3,191	N/A	N/A	N/A	47.8x	0.5x	-4.9%	-2.1%	0.55x	N/A
Shanghai Zhenhua Heavy Industries	3,481	63.8x	37.5x	15.5x	14.3x	1.7x	2.6%	4.5%	1.49x	1.7%
Sembcorp Marine	3,825	93.1x	55.0x	26.1x	22.6x	2.0x	2.3%	3.5%	1.13x	0.8%
<b>Average:</b>		<b>38.5x</b>	<b>47.2x</b>	<b>16.2x</b>	<b>20.7x</b>	<b>1.2x</b>	<b>5.2%</b>	<b>3.9%</b>	<b>0.81x</b>	<b>1.9%</b>
<b>Median:</b>		<b>18.7x</b>	<b>37.5x</b>	<b>15.5x</b>	<b>16.5x</b>	<b>1.2x</b>	<b>4.7%</b>	<b>4.0%</b>	<b>0.55x</b>	<b>2.1%</b>

Source: Bloomberg Finance L.P., Companies, DBS Bank

## Robust Project Pipelines

**New orders in 2017 were all non-drilling solutions.** These included FPSOs, gas vessels and specialised vessels such as LNG fueled containerships, heavylift vessels and dredgers.

**SMM's secured newbuild FPSO (hull and accommodation quarter) contract from Statoil was a breakthrough.** In Dec 2017,

SMM secured a turnkey engineering, procurement and construction contract of a hull and living quarters for a newbuild FPSO for Statoil's Johan Castberg project, which followed the LOI signed in early Nov.

This is a breakthrough, marking SMM's first newbuild FPSO project which has typically been clinched by Korean peers.

## Order wins secured in 2017

Date announced	Type of rig / vessel	Value, Est (\$ m)	Job scope	End	Customer
<b>Keppel</b>					
23-May	Trailing Suction Hopper Dredgers	120	build two Trailing Suction Hopper Dredgers (TSHDs).	2H19	Codralux S.A.
24-May	LNG carriers	103	build two LNG carrier vessels	2Q/3Q 19	Stolt-Nielsen Gas B.V
28-Jun	FPSO, LNG, heavylift vessels	85	four contracts for conversion, repair and modification of FPSO vessels, LNG tankers, as well as heavy lift vessels	3Q17-3Q18	Various
24-Aug	LNG containerships	544	build two LNG fueled containerships sized 2525 TEU for Jones Act market (US)	1Q20 / 3Q20	Pasha Hawaii SBM
4-Oct	FPSO Conversion	125	Conversion of a VLCC into an FPSO. work scope includes refurbishment and life extension works, such as the upgrading of living quarters, fabrication and installation of spread mooring systems, as well as the installation and integration of topside modules.	mid-2019	Offshore N.V.
11-Dec	FPSO (hull carry over work)	40	The additional work scope on P-69 includes the installation of equipment and cables for the hull as well as the commissioning of marine systems.		Petrobras
11-Dec	FLNG (Turret Mooring system)	80	Fabrication of a Turret Mooring system for a newbuild Floating Liquefied Natural Gas (FLNG) vessel	1Q20	SOPEC
<b>Total FY17 order wins for Keppel O&amp;M</b>		<b>1,097</b>			
<b>SMM</b>					
31-Mar	FPSO	75	Variation orders for FPSO projects		-
11-Sep	FPSO P68 Tupi (variation hull carry over works)	194	Variation orders for FPSO project		Petrobras
6-Dec	FPSO	666	Newbuild floating production storage and offloading (FPSO) hull and living quarters for the Johan Castberg field development.	1Q20	Statoil
<b>Total FY17 order wins for SMM</b>		<b>935</b>			

Source: Company, DBS Bank

**Contract awards for production related facilities set to rise.** With oil prices sustaining above US\$60/bbl and substantial project cost reduction, we expect more projects to be sanctioned in

2018. We have compiled the list of projects, which Singapore rigbuilders have / could potentially tender for.

**Singapore Rigbuilders: Potential order pipeline for production related facilities**

Type	Operator	Project	Bidders	Front runner	Expected FID / Award of contract
FPSO (18k tonne processing Topside)	Statoil	Johan Castberg	<b>SMM</b> , SHI, HHI, Kvaerner	SMM	Early 2018
Semisub production unit	Shell	Vito	<b>SMM</b> , DSME, HHI, SHI, <b>Keppel</b> , COOEC, Kiewit Offshore	SMM	Early 2018
4 EPC contracts	Maersk	Tyra gas hub	<b>SMM</b> , Heerema Fabrication	SMM	Early 2018
FPSO	Energear	Karish-Tanin		SMM	Early 2018
FPSO	BP	Tortue	Hyundai, Samsung, <b>SMM</b>		Sep-2018
FPSO	Hess	Pecan	<b>Keppel</b> , <b>SMM</b>		End 2018
FPSO	Chevron	Rosebank	<b>SMM</b> , DSME, HHI, SHI	DSME	Late 2018 / Early 2019
Wellhead platform + FPSO	Eni	Amoca			2018
FPSO	Petrobras / Modec	Sepia	Cosco, Dalian, Bomesc, Zhuhai Jutal, <b>Keppel</b>	Keppel	
FPSO	Petrobras / Modec	Mero	Cosco, Dalian, Bomesc, Zhuhai Jutal, <b>Keppel</b>	Keppel	
Semi production unit	Cobalt	North Platte	<b>Keppel</b> , HHI		
FPSO (Processing platform)	ONGC	KG-DWN-98/2			
FPSO upgrade	Alpha	deep-water Cheviot			
FPSO	Petrobras	Libra-2			
FPSO	Petrobras	Buzios-5			
FPSO	Petrobras	Marlim			
FPSO	Petrobras	Parque das Baleias			
FPSO	Eni / Shell	ZabaZaba			
FPSO	Karoon	Echidna light oil			

Source: Upstream, Company

**SMM sees strong order win momentum.** SMM has a strong order pipeline worth over S\$3bn, potentially translating to firm orders over the next 12 months, including:

- 1) LOIs signed with SeaOne Caribbean for **two large Compressed Gas Liquid carriers**, totalling **S\$800m**;
- 2) Preferred bidder to build a **semi-submersible production unit**, estimated to cost **S\$400-800m**, for Shell's Vito project;
- 3) finalisation of its long-awaited first Gravifloat modularised **LNG exporting terminal** for Poly-GCL at c.**S\$1bn**; and
- 4) **FPSO processing topside** for Statoil's Johan Castberg project valued at **S\$200-400m**.

In addition, there could be other FPSO conversion projects and LNG importing terminals at price tag of S\$150-300m each.

We believe SMM's Gravifloat LNG terminal provides a unique cost efficient modular option to customers, and stands to be the next mainstream product of SMM. The value of these units can range from S\$200-\$300m for importing LNG terminals, and up to c.S\$1bn for exporting LNG terminals.

**Keppel focuses on FPSO and gas solutions.** We expect Keppel to secure :

- 1) Four **FPSO conversion projects** at S\$150-200m each. Two of which could come from its long-standing customer – Modec, which has just won two contracts to supply FPSOs to Petrobras' Sepia project in 4Q17;
- 2) Two LNG fueled **containerships** worth S\$500m for US' Jones Act market;
- 3) A **semisub production** unit worth S\$300-400m;

4) Four **specialised vessels** (dredgers, LNG carriers) worth S\$200m

5) **LNG solutions** amounting to S\$200m for JV with Singapore's Pavilion Gas and Indonesia's state-owned electricity provider PT Perusahaan Listrik Negara (PLN) to supply LNG to remote islands and locations in west Indonesia.

6) A **FLNG vessel** with a contract value of S\$900m.

#### Singapore Rigbuilders: Order wins expectations

Sembcorp Marine				Keppel O&M			
Type	Potential Customer / Project	Est.value (\$\$ m)	Status	Type	Potential Customer / Project	Est.value (\$\$ m)	Status
Modularised LNG Exporting Terminal	Poly-GCL	1,000	Advanced talks	FPSO conversion x4	Petrobras, Modec, others	600-800	Tender
Compressed Gas Liquid carriers x2	SeaOne Caribbean	800	LOI	LNG containership x2	Pasha Hawaii	500	-
Semisub Production Unit	Shell's Vito	400-800	LOI	Semisub Production Unit	-	300-400	Tender
FPSO (topside)	Statoil's Johan Castberg	200-400	Tender	Specialised vessels (LNG carriers, Dredgers) x4	-	200	-
Modularised LNG Importing Terminal	-	200-300	-	LNG solutions to remote Islands @ Indonesia	Keppel-Pavilion-PLN	200	-
FPSO conversion	-	200-300	-	FLNG	-	900	-
2,800-3,600				2,700-3,000			

Source: Various sources, Company, DBS Bank



## Sembcorp M&A and property redevelopment market expectation resurface

**SCI privatising SMM?** Parent Sembcorp Industries (SCI)'s strategic review is due for release in 1Q18. This has triggered the re-emergence of potential M&A among Keppel, SCI and SMM. There are market expectation of SCI privatising SMM, but we do not see a strong rationale for that happening. We continue to hold onto our thesis of injection of Keppel O&M into SMM, though we have not heard any news along this line. [\(Shipyards: Creating Global Champions: Time to reform, restructure and reposition\)](#)

**SMM - redevelopment potential for its 87 hectare Admiralty Yard?** The potential of SMM redeveloping its seafront Admiralty Yard into a waterfront township has resurfaced. Encompassing nearly 87 hectares or 870k square metres, the Admiralty Yard's lease is due in 2028. The redevelopment option was tabled for consideration when Admiralty Shipyard (previously known as Sembawang Shipyard) / JSL merger was initiated 20 years ago in 1997.

For this to happen, SMM will have to apply for rezoning of the shipyard and top up the land value. Based on our back-of-the-envelope calculation, the redevelopment can **potentially raise SMM's fair value by S\$0.64-S\$1.03 per share** (assuming a 5 year – 10-year redevelopment period).

**Admiralty Shipyard – redevelopment into a sea-front facing new town.** Sembawang New Town over the past two decades undergone a huge transformation and now is vibrant housing estate. Starting out as mainly public housing units, as a growing town, Sembawang continue to develop with more amenities and transport infrastructure and in recent years, saw the development of new private housing projects (namely Canberra Residences, The Nautical and Skypark Residences (Executive Condominiums)). With limited private residential option in Sembawang area, we believe that the waterfront facing SMM's Admiralty Shipyard (previously known as Sembawang Shipyard) along Admiralty Road East provides SMM with the potential to extract value from the current use as a shipyard.

Timing of this redevelopment is app, especially when the group is looking to relocate all its Singapore shipyards into an integrated mega-yard in 2024 in Tuas, thus the timing is also ripe for the group to reconsider alternative uses for the shipyard at Sembawang.

### At what cost?

Admiralty Shipyard sits on 860,715 sqm of prime sea-fronting land. Assuming that approvals for a non-landed residential housing zoning at a gross plot ratio (GPR) of 1.4x, potentially sellable gross floor area (GFA) could top 1.2m sqm (or 13m sqft). This will imply significant capital commitment that SMM will have to commit to develop the project. **Moreover, we note that SMM lacks the expertise as a property developer, which makes executing on this redevelopment uncertain at this moment.**

The rising land prices in Singapore amidst developers' thirst for land have resulted in government revising up the development charge (DC) rates across the island. Subject to SMM getting approval to convert the existing Admiralty Shipyard into a new residential project, we estimate that total differential premium (DP) payable will be hefty at close to S\$2.4bn (100% basis), implying a land price of S\$278psf, a number that is fairly low in today's context. This DP accounts for both (i) conversion of the industrial land into residential zoning and (ii) topping up the land tenure back to 99 leasehold.

Our back-of-the-envelope calculation shows that total capital commitment is close to S\$10bn (S\$778 psf) which is significant. Given SMM's gearing is at 1.1x, we see limited capacity to gear up further to develop the site. Therefore, we believe that a more conservative approach in redeveloping the site in phases could be an appropriate strategy, if it happens.

Assuming that SMM is able to complete selling the project at S\$1,100 psf, the total potential profit (after tax) for this development could top S\$3.5bn or an impact of close to S\$1.66/share. Given the uncertainty of execution and time needed to complete this project, the present value of this development could be closer to S\$0.64-S\$1.03/share (assuming a 5 years – 10 years development period).

### Keppel potential sale of six jackups to Borr Drilling

**Keppel disposing six jackup rigs to Borr.** Keppel has confirmed the Business Times article in relation to a possible sale of six jackup rigs to Borr Drilling. The discussions are ongoing and terms have yet to be finalised. Assuming the total transaction value of US\$960m reported in the article is true, it implies a

price tag of US\$160m per rig. This represents approx. 25% discount to original contract value of c.US\$215m. In view of the 20% downpayment collected from customer and potential 5-10% margin, we believe P&L impact should be minimal. Nevertheless, this is very positive news as it removes a key overhang of undelivered rigs. We believe eight out of 17 undelivered jackup rigs are at higher risk of seeing cancellations.

### Keppel's undelivered rigs

Type	Date announced	Type of rig / vessel	Contract value (US\$ m)	Contract Value, (S\$ m)	Original Delivery	Rescheduling	Customer
<b>SEMI-SUBMERSIBLES</b>							
Semi-sub	22-Dec-11	DSS 38E semisubmersible rig	809	1,043.6	4Q15	Deferred	Sete Brasil
Semi-sub	7-Aug-12	DSS 38E semisubmersible rig	824	1,030.0	4Q16	Deferred	Sete Brasil
Semi-sub	7-Aug-12	DSS 38E semisubmersible rig	824	1,030.0	3Q17	Deferred	Sete Brasil
Semi-sub	7-Aug-12	DSS 38E semisubmersible rig	824	1,030.0	2Q18	Deferred	Sete Brasil
Semi-sub	7-Aug-12	DSS 38E semisubmersible rig	824	1,030.0	4Q18	Deferred	Sete Brasil
Semi-sub	7-Aug-12	DSS 38E semisubmersible rig	824	1,030.0	3Q19	Deferred	Sete Brasil

### JACK-Ups

Jackup	21-Nov-13	KFELS Super A class	265.0	330.5	2Q16	2Q18	EnSCO PLC
Jackup	28-Mar-13	KFELS B Class	205	254.7	3Q15	4Q17	Grupo R
Jackup	28-Mar-13	KFELS B Class	205	254.7	4Q15	4Q17	Grupo R
Jackup	15-Jul-13	KFELS B Class	206	260.0	4Q15	4Q17	Grupo R
Jackup	2-Aug-13	KFELS B Class	206	261.6	4Q15	4Q17	Parden
Jackup	1-Oct-13	KFELS B Class	220	276.3	4Q15	4Q17	Clearwater
Jackup	1-Oct-13	KFELS B Class	220	276.3	1Q16	4Q17	Falcon
Jackup	3-Mar-14	KFELS N class plus	500	633.9	1Q17	4Q17	TS Offshore
Jackup	13-Feb-14	KFELS B class	217	274.3	3Q16	3Q19	Fecon
Jackup	13-Feb-14	KFELS B class	217	274.3	4Q16	3Q19	Fecon
Jackup	13-Feb-14	KFELS B class	217	274.3	4Q16	3Q19	Fecon
Jackup	7-Nov-13	KFELS Super B class	220	273.5	1Q16	1Q18	Borr Drilling
Jackup	7-Nov-13	KFELS Super B class	220	273.5	2Q16	2Q18	Borr Drilling
Jackup	7-Nov-13	KFELS Super B class	220	273.5	4Q16	2Q19	Borr Drilling
Jackup	7-Nov-13	KFELS Super B class	220	273.5	1Q17	2Q20	Borr Drilling
Jackup	7-Nov-13	KFELS Super B class	220	273.5	3Q17	4Q20	Borr Drilling
Jackup	31-Oct-14	KFELS Super B class	240	306.8	4Q16	1Q19	BOT Lease

\*Highlighted ones are projects at higher risks of cancellations in our view

Source: Company, DBS Bank

## Company Guides

# Singapore Company Guide

# Sembcorp Marine

Version 15 | Bloomberg: SMM SP | Reuters: SCMN.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

22 Jan 2018

## BUY

Last Traded Price ( 19 Jan 2018): S\$2.30 (STI : 3,550.36)

Price Target 12-mth: S\$3.10 (35% upside) (Prev S\$2.30)

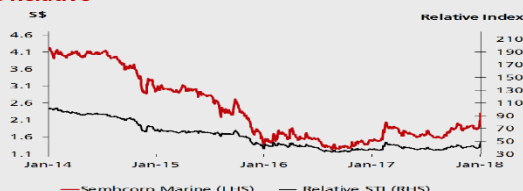
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## What's New

- Robust contract wins to drive rerating
- Merger more likely than privatisation
- Unlocking value from Admiralty Yard redevelopment? It could add S\$1 to SMM's target price
- Reiterate BUY; TP raised to S\$3.10

### Price Relative



### Forecasts and Valuation

FY Dec (\$ m)	2016A	2017F	2018F	2019F
Revenue	3,545	2,358	4,239	5,094
EBITDA	330	287	456	595
Pre-tax Profit	90.5	51.8	151	299
Net Profit	78.8	52.8	119	235
Net Pft (Pre Ex.)	78.8	6.00	119	235
Net Pft Gth (Pre-ex) (%)	nm	(92.4)	1,878.3	98.2
EPS (S cts)	3.77	2.53	5.68	11.3
EPS Pre Ex. (S cts)	3.77	0.29	5.68	11.3
EPS Gth Pre Ex (%)	(127)	(92)	1,878	98
Diluted EPS (S cts)	3.77	2.53	5.69	11.3
Net DPS (S cts)	2.50	0.91	1.99	15.2
BV Per Share (S cts)	123	123	127	137
PE (X)	61.0	91.0	40.5	20.4
PE Pre Ex. (X)	61.0	800.6	40.5	20.4
P/Cash Flow (X)	8.5	10.0	6.0	8.4
EV/EBITDA (X)	23.4	26.0	14.9	10.7
Net Div Yield (%)	1.1	0.4	0.9	6.6
P/Book Value (X)	1.9	1.9	1.8	1.7
Net Debt/Equity (X)	1.1	1.0	0.7	0.5
ROAE (%)	3.1	2.1	4.5	8.5
Earnings Rev (%):		(6)	7	10
Consensus EPS (S cts):		2.60	4.40	6.10
Other Broker Recs:		B: 6	S: 4	H: 10

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

## Best proxy to O&M recovery

**Maintain BUY; TP raised to S\$3.10**, based on higher 2.4x FY17 P/BV multiple (0.5SD below mean). We believe re-rating on Sembcorp Marine (SMM) will continue to be driven by: 1) SMM is a pure play to ride the oil price recovery; 2) Strong order pipeline for non-drilling solutions; 3) the reactivation of Sete's projects; and 4) SMM as a potential M&A play arising from a consolidation of Singapore yards. Our back of envelopment calculation estimates that the redevelopment potential of Admiralty Yard could add \$0.64-\$1/share to SMM's fair value, if it happens.

**Where we differ: more bullish on SMM's contract wins.** Order wins, a critical leading indicator for earnings recovery, is set to rise in the next 12 months. We believe SMM's strong order pipeline would translate to S\$3bn in new orders in 2018, which could potentially include 1) two large Compressed Gas Liquid carriers for SeaOne Caribbean valued at S\$800m in total; 2) a semi-submersible production unit for Shell's Vito at S\$400-800m; 3) a Gravifloat (SMM's proprietary technology) modularised LNG exporting terminal for Poly-GCL at c.S\$1bn; and 4) FPSO topside for Statoil worth S\$200-400m.

**Reactivation of Sete Brasil rig orders.** The landmark deal to sell all nine terminated jackup rigs to Borr Drilling and disposal of harsh environment semisubmersible rig West Rigel has eliminated the key overhanging concerns on SMM. The restructuring of customer Sete Brasil is also seemingly closer to a resolution, pending approval of the revised restructuring proposal submitted at end-Aug 2017. We believe Singapore rigbuilders are well positioned to deliver at least four rigs each (which are in the advance stages of construction) out of Sete Brasil's existing 13 orders (c.S\$1bn each). The reactivation of rig construction will be another re-rating catalyst.

### Valuation:

Our target price of S\$ 3.10 is based on 2.4x FY18 P/BV, pegged to 0.5SD below its mean valuation since 2004. SMM's book value has already been written down after the massive S\$609m provisions taken in FY15.

### Key Risks to Our View:

Key downside risks are sustained low oil prices which would affect rig count and newbuilding activities, execution risks in new product types, and disposal of jackup rigs at a loss. Upside risk could come from privatisation or M&A activities, as well as the write-back of provisions from successful deliveries or vessel sales.

### At A Glance

Issued Capital (m shrs)	2,088
Mkt. Cap (S\$m/US\$m)	4,802 / 3,636
Major Shareholders (%)	
Sembcorp Industries Ltd	61.0
Franklin Resources	5.0
Free Float (%)	34.0
3m Avg. Daily Val (US\$m)	9.8
ICB Industry : Oil & Gas / Oil Equipment, Services & Dist	

## WHAT'S NEW

### Spinning M&A stories

**SMM sees strong order win momentum.** SMM has a strong order pipeline worth over S\$3bn, potentially translating to firm orders over the next 12 months, including:

- 1) LOIs signed with SeaOne Caribbean for **two large Compressed Gas Liquid carriers**, totalling **S\$800m**;
- 2) Preferred bidder to build a **semi-submersible production unit**, estimated to cost **S\$400-800m**, for Shell's Vito project;
- 3) finalisation of its long-awaited first Gravifloat modularised **LNG exporting terminal** for Poly-GCL at c.**S\$1bn**; and
- 4) **FPSO processing topside** for Statoil's Johan Castberg project valued at **S\$200-400m**.

In addition, there could be other FPSO conversion projects and LNG importing terminals at a price tag of S\$150-300m each.

We believe SMM's Gravifloat LNG terminal provides a unique cost efficient modular option to customers, and stands to be the next mainstream product of SMM. The value of these units can range from S\$200-\$300m for importing LNG terminals, and up to c.S\$1bn for exporting LNG terminals.

**SCI privatising SMM?** Parent Sembcorp Industries (SCI)'s strategic review is due for release in 1Q18. This has triggered the re-emergence of potential M&A among Keppel, SCI and SMM. There are market expectation of SCI privatising SMM, but we do not see a strong rationale for that happening. We continue to hold on to our thesis of injection of Keppel O&M into SMM, though we have not heard any news along this line. [\(Shipyards: Creating Global Champions: Time to reform, restructure and reposition\).](#)

**SMM - redevelopment potential for its 87 hectare Admiralty Yard?** The potential of SMM redeveloping its seafront Admiralty Yard into a waterfront township has resurfaced. Encompassing nearly 87 hectares or 870k square metres, the Admiralty Yard's lease is due in 2028. The redevelopment option was tabled for consideration when Admiralty Shipyard (previously known as Sembawang Shipyard) / JSL merger was initiated 20 years ago in 1997.

For this to happen, SMM will have to apply for rezoning of the shipyard and top up the land value. Based on our back-of-the-envelope calculation, the redevelopment can **potentially raise SMM's fair value by S\$1.03 per share**.

**Admiralty Shipyard – redevelopment into a sea-front facing new town.** Sembawang New Town over the past two decades undergone a huge transformation and now is vibrant housing estate. Starting out as mainly public housing units, as a

growing town, Sembawang continue to develop with more amenities and transport infrastructure and in recent years, saw the development of new private housing projects (namely Canberra Residences, The Nautical and Skypark Residences (Executive Condominiums). With limited private residential option in Sembawang area, we believe that the waterfront facing SMM's Admiralty Shipyard (previously known as Sembawang Shipyard) along Admiralty Road East provides SMM with the potential to extract value from the current use as a shipyard.

Timing of this redevelopment is app, especially when the group is looking to relocate all its Singapore shipyards into an integrated mega-yard in 2024 in Tuas, thus the timing is also ripe for the group to reconsider alternative uses for the shipyard at Sembawang.

### At what cost?

Admiralty Shipyard sits on 860,715 sqm of prime sea-fronting land. Assuming that approvals for a non-landed residential housing zoning at a gross plot ratio (GPR) of 1.4x, potentially sellable gross floor area (GFA) could top 1.2m sqm (or 13m sqft). This will imply significant capital commitment that SMM will have to commit to develop the project. **Moreover, we note that SMM lacks the expertise as a property developer, which makes executing on this redevelopment uncertain at this moment.**

The rising land prices in Singapore amidst developers' thirst for land have resulted in government revising up the development charge (DC) rates across the island. Subject to SMM getting approval to convert the existing Admiralty Shipyard into a new residential project, we estimate that total differential premium (DP) payable will be hefty at close to S\$2.4bn (100% basis), implying a land price of S\$278psf, a number that is fairly low in today's context. This DP accounts for both (i) conversion of the industrial land into residential zoning and (ii) topping up the land tenure back to 99 leasehold.

Our back-of-the-envelope calculation shows that total capital commitment is close to S\$10bn (S\$778 psf) which is significant. Given SMM's gearing is at 1.1x, we see limited capacity to gear up further to develop the site. Therefore, we believe that a more conservative approach in redeveloping the site in phases could be an appropriate strategy, if it happens.

Assuming that SMM is able to complete selling the project at S\$1,100 psf, the total potential profit (after tax) for this development could top S\$3.5bn or an impact of close to S\$1.66/share. Given the uncertainty of execution and time needed to complete this project, the present value of this development could be closer to S\$0.64-S\$1.03/share (assuming a 5 years – 10 years development period).

## CRITICAL DATA POINTS TO WATCH

## Critical Factors

**Oil price rebound and reversal in capex trend.** OPEC's output cut effective 1 January 2017 brought forward oil equilibrium to 2Q17, and led to an oil price recovery and capex increase after 2-3 years of contraction. The injection of cashflow, through oil majors' capex into the O&G ecosystem, is much needed to stimulate O&G activity.

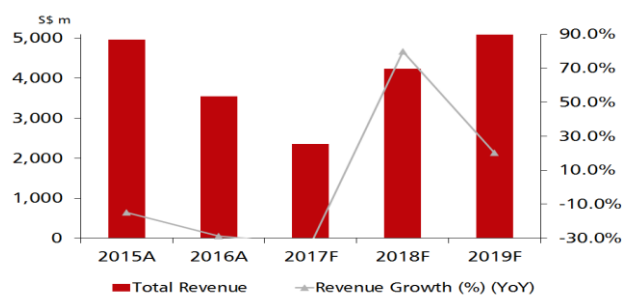
**Order-book replenishment.** Order wins and order-book trends are often the key drivers of rigbuilders' share prices and earnings. Based on existing capacity, SMM requires ~S\$4bn worth of order replenishments every year in an ideal case. We expect new orders to recover in FY18 from the dismal ~S\$300m in FY16 and S\$1bn in FY17, driven by the new Gravifloat modularised LNG terminal solutions. SMM's net order-book stood at S\$7.97bn as at Sept 2017, with c.39% from the drillship projects with Sete Brasil. This translates into a book-to-bill ratio of over 2x based on the existing delivery schedule.

**Rig utilisation and day rates bottoming out,** uptick in offshore rig count since January 2017. Utilisation and day rates have fallen by around 40-50% from June 2014 levels. On a positive note, utilisation rates seem to be bottoming out. Offshore rig count saw a first uptick in January 2017. We believe a gradual recovery in oil prices and the rig market will set the stage for rising newbuild demand thereafter.

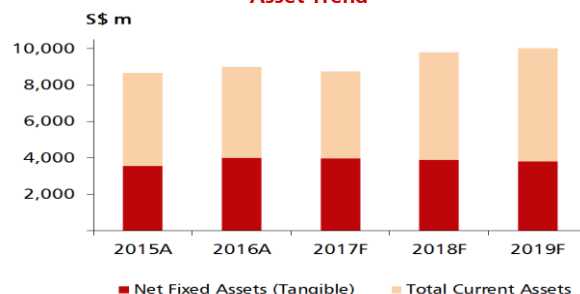
**Pace of rigbuilding recovery** is dependent on oil price rebound, retirement of old fleets, and cancellations at Chinese yards. Oil price rebounding above US\$60/bbl will stimulate E&P activities and thus rig demand, while rig attrition and cancellations will soothe the supply pressure and eventually bring the sector back to equilibrium.

**Shipyard merger on the cards?** While the macro outlook has improved, the rigbuilding sector continues to face structural issues with yard overcapacity and rig oversupply. Both Singapore rigbuilders have been rationalising their operations since early 2015 to cope with the lower activity level. A merger could make sense to further streamline their operations, achieve cost synergies and eliminate competition in the medium term.

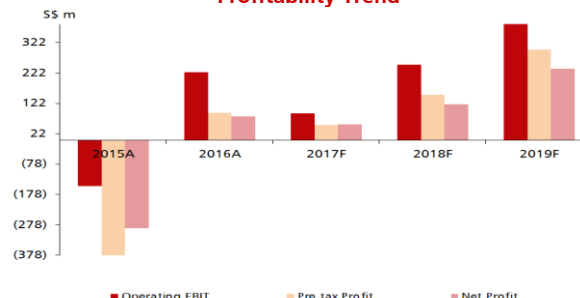
Sales Trend



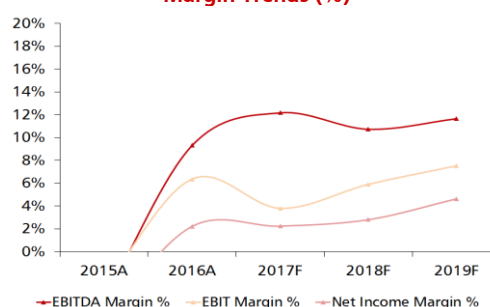
Asset Trend



Profitability Trend



Margin Trends (%)



Source: Company, DBS Bank



### Balance Sheet:

Net gearing stood at 1.3x as at end-Sept 2017, but would have been lower at 1.04x factoring in Borr's S\$500m downpayment received in Oct. Gearing level should decline to below 1x by 2019 with the delivery of the jackup rig and collection from Borr Drilling. In addition, the completion of the new yard in 2016 should reduce yard capex to a more normalised level of S\$100-200m going forward. Most of SMM's current projects are non-drilling solutions, which are largely on progressive payment terms, and thus have lower working capital requirements

### Share Price Drivers:

**Recovery in oil prices.** Rising oil prices typically lift sentiment on rigbuilders. We believe SMM would benefit if oil prices recover and are sustained at least at the US\$60/bbl level, which would trigger more offshore oil & gas capex spending.

**Order win momentum.** Shipyards are orderbook-driven. Strong order flows could push up their share prices, as investors reward greater visibility on revenues and earnings.

**Restructuring of Sete Brasil.** The successful restructuring of Sete Brasil will allow the rig owner to obtain financing for its rig-building programme. This will eliminate an overhang on the rig-builders.

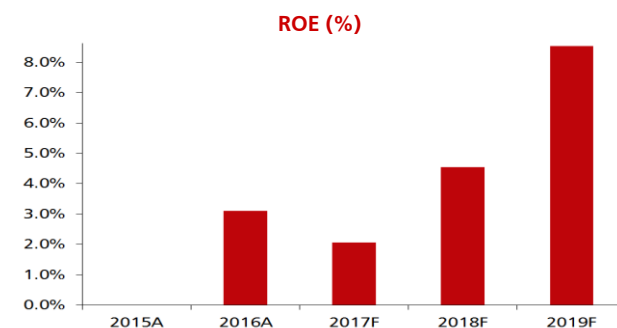
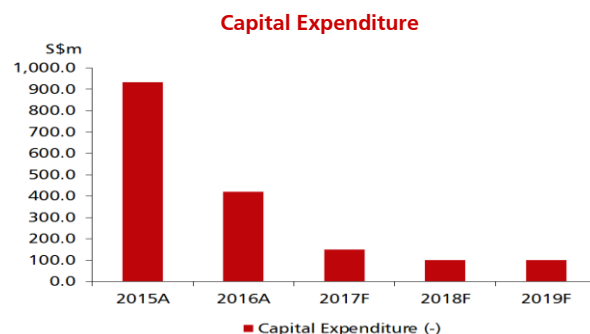
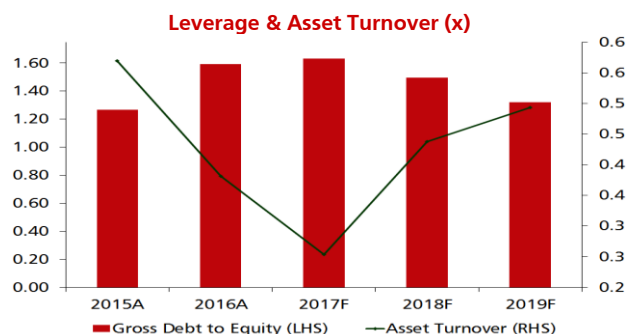
### Key Risks:

**Sustained low oil price.** Brent crude oil prices of below US\$60/bbl would defer investments into deepwater projects, and higher-cost oilfield projects. This could dampen newbuild demand for drilling rigs, especially floaters.

**Rig supply glut and competition.** A slower order flow is expected, as the market takes time to absorb about 160 rigs scheduled for delivery in the next two years, representing c.20% of its existing fleet. Competition has intensified with the low order backlog of Korean yards and emergence of Chinese shipyards in the offshore space.

### Company Background

Sembcorp Marine (SMM) is a pure play in the offshore & marine sector. Its principal activities are rig-building and offshore engineering, ship conversion, ship repair and building of specialised vessels.



Source: Company, DBS Bank

## Key Assumptions

FY Dec	2015A	2016A	2017F	2018F	2019F
New order wins (\$\$ m)	3,128	320	931	3,000	3,000

## Segmental Breakdown

FY Dec	2015A	2016A	2017F	2018F	2019F
<b>Revenues (\$\$m)</b>					
Rigs & Floaters	3,319	1,887	1,068	2,795	3,277
Offshore Platforms	1,017	1,116	679	778	1,106
Repairs & Upgrades	557	460	531	586	631
Specialised Shipbuilding	0.0	0.0	0.0	0.0	0.0
Others	75.8	82.1	80.0	80.0	80.0
<b>Total</b>	<b>4,968</b>	<b>3,545</b>	<b>2,358</b>	<b>4,239</b>	<b>5,094</b>

## Income Statement (\$\$m)

FY Dec	2015A	2016A	2017F	2018F	2019F
Revenue	4,968	3,545	2,358	4,239	5,094
Cost of Goods Sold	(4,837)	(3,252)	(2,215)	(3,853)	(4,544)
<b>Gross Profit</b>	<b>131</b>	<b>293</b>	<b>144</b>	<b>385</b>	<b>551</b>
Other Opng (Exp)/Inc	(281)	(67.4)	(54.2)	(136)	(168)
<b>Operating Profit</b>	<b>(150)</b>	<b>225</b>	<b>89.5</b>	<b>250</b>	<b>383</b>
Other Non Opg (Exp)/Inc	(18.2)	(18.9)	0.0	0.0	0.0
Associates & JV Inc	(173)	(35.1)	3.00	5.00	7.00
Net Interest (Exp)/Inc	(36.0)	(80.7)	(87.6)	(104)	(90.5)
Exceptional Gain/(Loss)	0.0	0.0	46.8	0.0	0.0
<b>Pre-tax Profit</b>	<b>(378)</b>	<b>90.5</b>	<b>51.8</b>	<b>151</b>	<b>299</b>
Tax	77.6	(15.4)	0.52	(27.2)	(53.8)
Minority Interest	10.3	3.62	0.52	(4.9)	(9.8)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
<b>Net Profit</b>	<b>(290)</b>	<b>78.8</b>	<b>52.8</b>	<b>119</b>	<b>235</b>
Net Profit before Except.	(290)	78.8	6.00	119	235
EBITDA	(210)	330	287	456	595
<b>Growth</b>					
Revenue Gth (%)	(14.8)	(28.6)	(33.5)	79.7	20.2
EBITDA Gth (%)	nm	nm	(13.0)	58.5	30.5
Opg Profit Gth (%)	(121.2)	(250.2)	(60.3)	178.8	53.3
Net Profit Gth (Pre-ex) (%)	nm	nm	(92.4)	1,878.3	98.2
<b>Margins &amp; Ratio</b>					
Gross Margins (%)	2.6	8.3	6.1	9.1	10.8
Opg Profit Margin (%)	(3.0)	6.4	3.8	5.9	7.5
Net Profit Margin (%)	(5.8)	2.2	2.2	2.8	4.6
ROAE (%)	(10.6)	3.1	2.1	4.5	8.5
ROA (%)	(3.3)	0.8	0.6	1.2	2.3
ROCE (%)	(2.6)	2.8	1.3	2.9	4.5
Div Payout Ratio (%)	N/A	66.3	36.0	35.0	135.0
Net Interest Cover (x)	(4.2)	2.8	1.0	2.4	4.2

Source: Company, DBS Bank



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

FY Dec	3Q2016	4Q2016	1Q2017	2Q2017	3Q2017
Revenue	888	830	760	655	317
Cost of Goods Sold	(817)	(795)	(740)	(579)	(304)
<b>Gross Profit</b>	<b>71.0</b>	<b>34.7</b>	<b>19.9</b>	<b>76.3</b>	<b>12.4</b>
Other Oper. (Exp)/Inc	(38.0)	32.4	(6.4)	(47.8)	9.58
<b>Operating Profit</b>	<b>32.9</b>	<b>67.1</b>	<b>13.6</b>	<b>28.5</b>	<b>22.0</b>
Other Non Opg (Exp)/Inc	(3.9)	(16.2)	0.02	(4.6)	(1.1)
Associates & JV Inc	(27.7)	(5.3)	(0.7)	(0.5)	(0.7)
Net Interest (Exp)/Inc	(19.6)	(24.3)	(22.9)	(19.8)	(22.0)
Exceptional Gain/(Loss)	0.0	0.0	46.8	0.0	0.0
<b>Pre-tax Profit</b>	<b>(18.3)</b>	<b>21.3</b>	<b>36.8</b>	<b>3.52</b>	<b>(1.8)</b>
Tax	(3.5)	9.36	2.77	0.19	3.42
Minority Interest	0.02	3.66	0.0	1.89	1.06
<b>Net Profit</b>	<b>(21.8)</b>	<b>34.3</b>	<b>39.5</b>	<b>5.59</b>	<b>2.72</b>
Net profit bef Except.	(21.8)	34.3	(7.3)	5.59	2.72
EBITDA	36.8	98.7	59.9	71.6	69.9

### Growth

Revenue Gth (%)	(2.3)	(6.5)	(8.4)	(13.8)	(51.7)
EBITDA Gth (%)	(51.7)	168.5	(39.4)	19.6	(2.3)
Opg Profit Gth (%)	(38.5)	103.7	(79.7)	109.7	(22.7)
Net Profit Gth (Pre-ex) (%)	(290.3)	(257.4)	(121.2)	(177.1)	(51.4)

### Margins

Gross Margins (%)	8.0	4.2	2.6	11.6	3.9
Opg Profit Margins (%)	3.7	8.1	1.8	4.3	6.9
Net Profit Margins (%)	(2.5)	4.1	5.2	0.9	0.9

### Balance Sheet (\$\$m)

FY Dec	2015A	2016A	2017F	2018F	2019F
Net Fixed Assets	3,541	3,987	3,960	3,878	3,791
Invt in Associates & JVs	312	74.8	77.8	82.8	89.8
Other LT Assets	231	335	335	335	335
Cash & ST Invt	690	1,269	1,648	2,126	2,359
Inventory	3,833	3,067	2,621	3,028	2,997
Debtors	590	492	328	565	679
Other Current Assets	3.89	191	191	191	191
<b>Total Assets</b>	<b>9,201</b>	<b>9,415</b>	<b>9,159</b>	<b>10,204</b>	<b>10,441</b>
ST Debt	915	1,364	1,664	1,664	1,664
Creditor	2,519	2,120	1,814	2,826	2,997
Other Current Liab	463	264	215	343	406
LT Debt	2,465	2,791	2,591	2,391	2,191
Other LT Liabilities	175	268	268	268	268
Shareholder's Equity	2,511	2,562	2,563	2,662	2,856
Minority Interests	153	45.6	45.1	50.1	59.9
<b>Total Cap. &amp; Liab.</b>	<b>9,201</b>	<b>9,415</b>	<b>9,159</b>	<b>10,204</b>	<b>10,441</b>
Non-Cash Wkg. Capital	1,445	1,365	1,110	614	464
Net Cash/(Debt)	(2,690)	(2,886)	(2,607)	(1,929)	(1,496)
Debtors Turn (avg days)	38.9	55.7	63.4	38.4	44.6
Creditors Turn (avg days)	168.5	273.7	355.5	231.8	244.9
Inventory Turn (avg days)	265.2	407.1	513.9	282.2	253.4
Asset Turnover (x)	0.6	0.4	0.3	0.4	0.5
Current Ratio (x)	1.3	1.3	1.3	1.2	1.2
Quick Ratio (x)	0.3	0.5	0.5	0.6	0.6
Net Debt/Equity (X)	1.0	1.1	1.0	0.7	0.5
Net Debt/Equity ex MI (X)	1.1	1.1	1.0	0.7	0.5
Capex to Debt (%)	27.6	10.1	3.5	2.5	2.6
Z-Score (X)	1.2	1.2	1.1	1.2	1.3

Source: Company, DBS Bank

## Cash Flow Statement (\$m)

FY Dec	2015A	2016A	2017F	2018F	2019F
Pre-Tax Profit	(378)	90.5	51.8	151	299
Dep. & Amort.	132	159	177	183	187
Tax Paid	(104)	(28.0)	(36.8)	0.52	(27.2)
Assoc. & JV Inc/(loss)	173	35.1	(3.0)	(5.0)	(7.0)
Chg in Wkg.Cap.	(291)	284	293	468	124
Other Operating CF	(521)	27.5	0.0	0.0	0.0
<b>Net Operating CF</b>	<b>(989)</b>	<b>569</b>	<b>481</b>	<b>797</b>	<b>575</b>
Capital Exp.(net)	(932)	(421)	(150)	(100.0)	(100.0)
Other Invt.(net)	0.0	0.0	0.0	0.0	0.0
Invt in Assoc. & JV	0.0	(3.3)	0.0	0.0	0.0
Div from Assoc & JV	0.0	0.0	0.0	0.0	0.0
Other Investing CF	0.0	(65.9)	0.0	0.0	0.0
<b>Net Investing CF</b>	<b>(932)</b>	<b>(490)</b>	<b>(150)</b>	<b>(100.0)</b>	<b>(100.0)</b>
Div Paid	(265)	(73.7)	(52.2)	(19.0)	(41.6)
Chg in Gross Debt	1,744	768	100	(200)	(200)
Capital Issues	(11.3)	(3.0)	0.0	0.0	0.0
Other Financing CF	2.02	(157)	0.0	0.0	0.0
<b>Net Financing CF</b>	<b>1,469</b>	<b>534</b>	<b>47.8</b>	<b>(219)</b>	<b>(242)</b>
Currency Adjustments	4.71	(22.7)	0.0	0.0	0.0
Chg in Cash	(447)	590	379	478	233
Opg CFPS (\$ cts)	(33.4)	13.6	9.02	15.7	21.6
Free CFPS (\$ cts)	(92.0)	7.05	15.8	33.4	22.7

Source: Company, DBS Bank

## Target Price &amp; Ratings History



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

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	23 Feb 17	1.82	1.78	BUY
2:	13 Mar 17	1.86	1.78	BUY
3:	02 May 17	1.65	1.78	BUY
4:	03 Jul 17	1.66	1.78	BUY
5:	20 Jul 17	1.74	2.30	BUY
6:	26 Jul 17	1.76	2.30	BUY
7:	28 Jul 17	1.70	2.30	BUY
8:	20 Sep 17	1.66	2.30	BUY
9:	04 Oct 17	1.75	2.30	BUY
10:	09 Oct 17	1.82	2.30	BUY
11:	01 Nov 17	2.01	2.30	BUY
12:	06 Nov 17	1.96	2.30	BUY
13:	10 Nov 17	1.97	2.30	BUY

Source: DBS Bank

Analyst: Pei Hwa HO

# Singapore Company Guide

## Sembcorp Industries

Version 15 | Bloomberg: SCI SP | Reuters: SCIL.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

22 Jan 2018

### BUY

Last Traded Price (19 Jan 2018): S\$3.39 (STI : 3,550.36)

Price Target 12-mth: S\$4.50 (33% upside) (Prev S\$4.20)

#### Analyst

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### What's New

- Riding on O&M recovery via SMM
- Awaiting announcement of strategic review outcome
- More collaboration between SCI and SMM, if stake is retained
- Reiterate BUY; TP lifted to S\$4.50

#### Price Relative



#### Forecasts and Valuation

FY Dec (\$\$ m)	2016A	2017F	2018F	2019F
Revenue	7,907	7,760	9,914	10,875
EBITDA	1,305	1,310	1,347	1,428
Pre-tax Profit	537	418	536	619
Net Profit	395	281	410	473
Net Pft (Pre Ex.)	407	374	410	473
Net Pft Gth (Pre-ex) (%)	230.1	(8.1)	9.5	15.3
EPS (\$ cts)	22.1	15.7	22.9	26.4
EPS Pre Ex. (\$ cts)	22.8	20.9	22.9	26.4
EPS Gth Pre Ex (%)	230	(8)	10	15
Diluted EPS (\$ cts)	21.9	15.6	22.8	26.3
Net DPS (\$ cts)	7.99	5.04	7.34	8.46
BV Per Share (\$ cts)	375	383	401	420
PE (X)	15.3	21.5	14.7	12.8
PE Pre Ex. (X)	14.8	16.2	14.7	12.8
P/Cash Flow (X)	6.9	22.4	2.7	3.0
EV/EBITDA (X)	11.4	12.0	10.8	9.5
Net Div Yield (%)	2.4	1.5	2.2	2.5
P/Book Value (X)	0.9	0.9	0.8	0.8
Net Debt/Equity (X)	0.9	1.0	0.8	0.7
ROAE (%)	6.0	4.2	5.9	6.4
Earnings Rev (%):		(1)	(1)	0
Consensus EPS (\$ cts):		20.0	23.7	28.7
Other Broker Recs:		B: 9	S: 1	H: 6

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

### Awaits Strategic Review

**Maintain BUY; TP raised to S\$4.50**, after raising our target price for Sembcorp Marine (SMM) from S\$2.30 to S\$3.10. While weakness in India may take longer to resolve, we continue to like Sembcorp Industries (SCI) as it offers a unique value proposition as a proxy to ride the cyclical O&M upturn, and is supported by a defensive utilities business. Our S\$4.50 TP translates to 1.1x P/BV, which we believe is fair in view of its 6% ROE and 2% dividend yield. The stock offers 33% potential upside.

**Strategic review gives rise to speculation.** Under the helm of the new CEO, SCI has undertaken a complete review of its businesses and strategic direction, focusing on performance, sustainability, and value creation. The review was concluded in 4Q17 and management is finalising the action plans which shall be revealed in 1Q18. While premature to shed more light on the future direction of SCI, this may revive market speculation on potential rationalisation of SCI, SMM, and Keppel Corporation (Keppel). We also expect the review to focus on IPO of its mature assets, and expansion plans along the LNG value chain.

**Where we differ:** "Big three rationalisation theory" and long-term growth prospects of utilities. Since Aug-2015, we have flagged the potential of a merger between Keppel's O&M arm and SMM in view of keener competition. The potential spin-off of its marine arm could re-rate SCI's undervalued utilities business that is overshadowed by the cyclical marine business. We believe in the long-term growth prospects of SCI's utilities arm, which has expanded its global footprint and recently made forays into key emerging markets – India, Bangladesh and Myanmar.

#### Valuation:

Given its diverse earnings stream and various listed assets, we derive our fair value for SCI based on the sum of its different parts. For its holding company position, we applied a 10% conglomerate discount to the reappraised net asset value (RNAV). We derive a TP of S\$4.50, translating to 1.1x P/BV.

#### Key Risks to Our View:

Key risks to earnings are further deferments/cancellations of marine projects, deterioration of Singapore's power spark spreads, and execution hiccups at its Indian power plants.

#### At A Glance

Issued Capital (m shrs)	1,784
Mkt. Cap (\$m/US\$m)	6,049 / 4,573
Major Shareholders (%)	
Temasek Holdings Pte Ltd	49.5
Mondrian Investment Partners Ltd	4.9
Free Float (%)	45.6
3m Avg. Daily Val (US\$m)	7.9
ICB Industry : Oil & Gas / Oil Equipment, Services & Dist	

## WHAT'S NEW

### Awaiting Strategic Review

**IPO of India assets.** Listing of SCI's mature assets with steady cash flow would help release capital for recycling and provide uplift to ROE. It has been reported in local media that SCI is considering IPO of its power plants in India. We believe it makes sense to IPO the first power plant, TPCIL, which is churning stable recurring profits backed by long-term PPA. The plant is expected to contribute c.S\$60m to SCI's net earnings. Assuming 12x PE, it could result in over S\$100m or 6 Scts/share revaluation gain post listing.

**LNG expansion plan:** LNG, the more sustainable and greener source of energy, seems to be a good fit in view of SCI's focus on performance, sustainability, and value creation. We expect more concrete expansion plans and possibly M&As such as gas terminal to be revealed.

**More collaboration with SMM, if keeping marine within the group.** We are a believer of SCI spinning off SMM to stay focused on its core competency in utilities. This could provide immediate uplift to utilities valuation which has been trading at an unwarranted 20-30% discount to book.

If management decides to keep the marine business and ride the recovery, we expect more collaboration between the two. For instance, SCI could place orders with SMM to build gas related vessels.

If the market talks of SMM potentially redeveloping its Admiralty Yard turns out to be true, SCI could offer its expertise in property development as well.

### SCI's SOTP-based valuation

	Value (S\$ m)	Basis
Sembcorp Marine	3,926	Fair value for Sembcorp Marine
Gallant Ventures	75	Share price
Salalah	347	40% stake
	<b>4,348</b>	
Less: book value of listed companies	(1,859)	
<b>Surplus / (Deficit) from listed companies</b>	<b>2,489</b>	
Utilities	4,276	Based on 13x FY18 PE
Urban Development	543	Based on 13x FY18 PE
	<b>4,818</b>	
Less: book value of Utilities	(4,418)	
book value of Urban Development	(766)	
	<b>(5,184)</b>	
<b>Surplus / (Deficit) from unlisted companies</b>	<b>(366)</b>	
<b>Net Surplus / (Deficit)</b>	<b>2,123</b>	
Book value as of end FY16	6,840	
RNAV	8,963	
<b>RNAV per share (S\$)</b>	<b>4.98</b>	
<b>Fair value (S\$)</b>	<b>4.50</b>	10% conglomerate discount

Source: Company, DBS Bank, Bloomberg Finance L.P

**CRITICAL DATA POINTS TO WATCH****Critical Factors**

**Beyond the transitional 2017.** While Thermal Powertech Corporation India (TPCIL) - SCI's first Indian power plant- is starting to contribute more steadily at S\$10-15m a quarter to the bottomline, profit could be offset by startup losses of its second plant, SembcorpGayatri Power Ltd (SGPL), which came online only in Feb-2017. SGPL's profitability will be more volatile as it is exposed to spot and short term markets, until it secures a long-term Power Purchase Agreement (PPA) from 2018 onwards. In China, there is a "loss of income" of c.S\$40m following the expiry of its YangCheng power plant at the end of 2016, while the new Chongqing plant will probably contribute more meaningfully from 2017. As a result, the utility segment may see a 10-15% drop in earnings in 2017 before resuming growth next year.

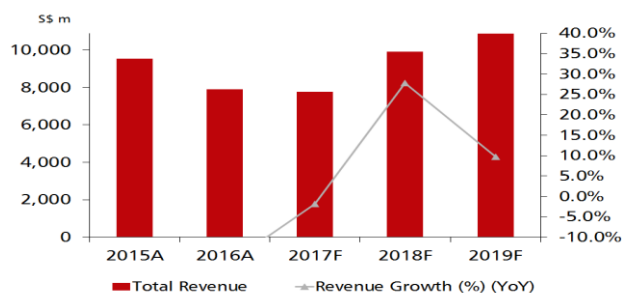
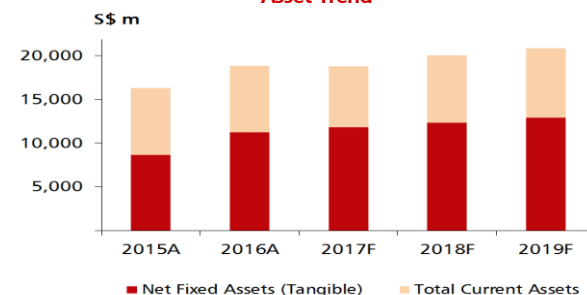
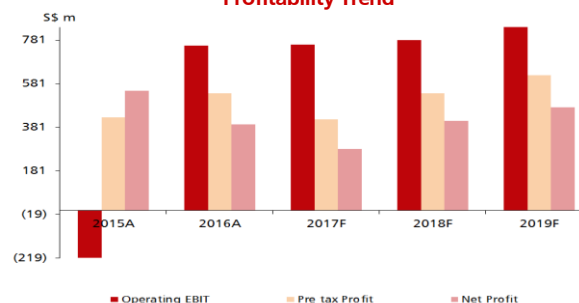
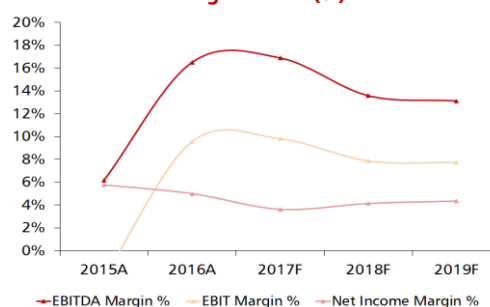
**Utilities in emerging markets remain the growth engine.** Besides India, SCI has also made forays into other emerging markets - Bangladesh and Myanmar - and this should underpin the longer-term growth prospects of its utilities segment beyond 2018. Long-term PPAs have been secured for both Myanmar's 230MW gas fired Myingyan Independent Power Producer (IPP) and Bangladesh's 427MW gasfired Sirajganj Unit 4. Construction of the plants are on track and expected to commence operations in 2H18.

**Marine business (SMM) earnings are orderbook-driven.** We expect new orders to recover in FY18 from the dismal ~S\$300m in FY16 and S\$1bn in FY17, driven by the new Gravifloat modularized LNG terminal solutions. SMM's orderbook stood at S\$7.97bn as at Sept 2017, with c.39% from the drillship projects with Sete Brasil. This translates into a book-to-bill ratio of over 2x based on existing delivery schedule.

**Urban Development business provides growth opportunities.**

Urban Development accounts for c.10% of SCI's bottom line on average and earnings tend to be lumpy. A strong performance from this segment may not move the needle too much for now, but represents an avenue for growth. SCI has about 3,500ha of saleable land remaining across China, Indonesia and Vietnam, which it can develop.

**Potential "Big Three Rationalisation"?** Since Aug-2015, we have flagged up the potential of a merger between Keppel's O&M arm and SMM in a structural downturn. There are various ways to embark on the rationalisation exercise of the big three homegrown industrial plays - SCI, SMM and Keppel Corp. We believe at the end of any potential exercise, Keppel Corp will remain as a conglomerate with multi-pronged businesses; SMM as pure marine play and SCI as a pure utilities play. In that case, SCI could emerge as a clear winner in this exercise as the spin-off of the marine arm could re-rate SCI's undervalued utilities business that is overshadowed by the cyclical marine business

**Sales Trend****Asset Trend****Profitability Trend****Margin Trends (%)**

Source: Company, DBS Bank

### Balance Sheet:

SCI's gearing stood at 1.0x as at Sept 2017 – a stark contrast to a net cash position in 2013; increasing leverage at SMM has been the main reason for the increase in debt level. Overall gearing remains at a palatable level and there is adequate debt headroom of approximately S\$1-2bn for SCI's expansion capex and working capital.

### Share Price Drivers:

**Oil price rebound would drive SCI's share price higher.** Investors would have greater confidence in the Marine business, as the operating environment improves. While drilling rig orders may lag oil price recovery, orders for non-drilling, production-related facilities may flow through.

**Order wins in the Marine segment and land sales from Urban Development bodes well for SCI's share price.** While the oil price rebound would be an early indicator, SMM securing contract wins is more tangible. More momentum in land sales would signal more hope for growth, and be positive to share price.

**Widening spark spreads at Singapore power plants.** Signs of positive and widening spark spreads in Singapore would alleviate a key concern of investors and provide support to the share price.

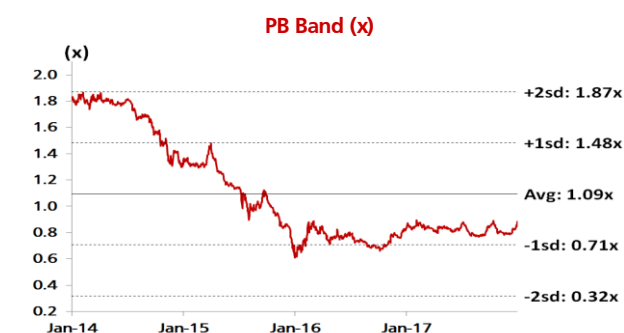
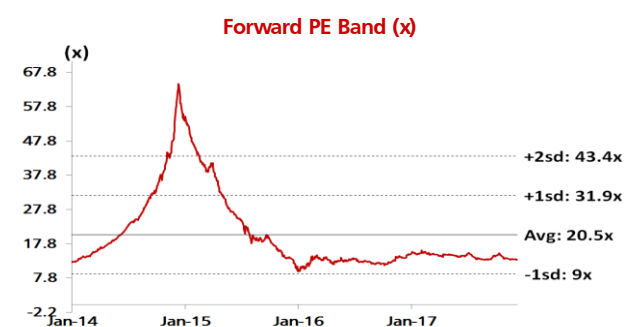
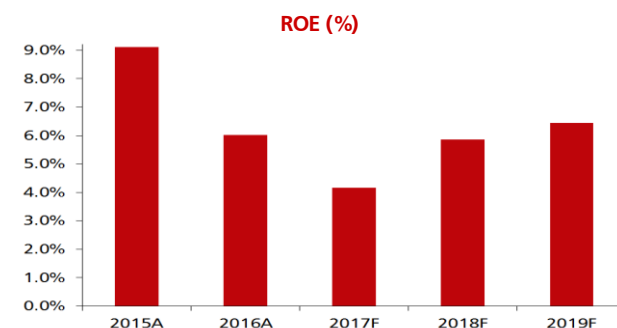
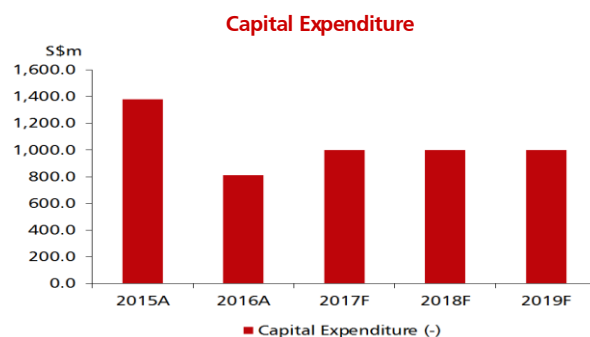
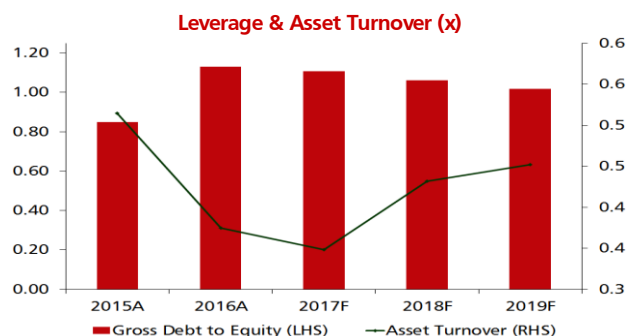
### Key Risks:

**Increasing competition in the Singapore power market.** Total power generation supply in Singapore rose by over 9% y-o-y in the past two years, marking the biggest y-o-y jumps since the electricity market started. This has depressed prices and hurt SCI's bottom line. The oversupply of capacity and over-commitment of gas supply issues will likely continue to plague Singapore's power market in the near-to-medium term.

**Execution of Indian power plants.** The availability of coal supply and power purchase agreements (PPA) for SCI's power plants in India are concerns. We find comfort that the TPCIL plant is up and running, with 86% of capacity committed on long-term PPAs and operating using both domestic and imported coal.

### Company Background

Sembcorp Industries (SCI) is a trusted provider of essential energy and water solutions to both industrial and municipal customers. It has facilities with 10,600MW of gross power capacity and over 10m cubic metres of water per day in operation and under development. It is also a world leader in marine and offshore engineering (via Sembcorp Marine) as well as an established brand name in urban development (comprising industrial parks as well as business, commercial and residential space) in Vietnam, China and Indonesia.



Source: Company, DBS Bank

## Key Assumptions

FY Dec	2015A	2016A	2017F	2018F	2019F
Marine contract wins	3,150	1,500	2,000	2,500	2,500

## Segmental Breakdown

FY Dec	2015A	2016A	2017F	2018F	2019F
<b>Revenues (\$\$m)</b>					
Utilities	4,227	4,112	5,195	5,506	5,640
Marine	4,967	3,544	2,358	4,239	5,094
Industrial Parks	7.95	7.05	10.3	12.4	14.9
Other Businesses and	342	245	196	157	125
<b>Total</b>	<b>9,545</b>	<b>7,908</b>	<b>7,760</b>	<b>9,914</b>	<b>10,875</b>
<b>Net Profit before EI (\$\$m)</b>					
Utilities	701	348	213	329	339
Marine	(176)	48.3	32.0	72.0	143
Industrial Parks	33.5	33.3	68.2	41.7	25.5
Other Businesses and	(9.7)	(34.7)	(31.2)	(32.8)	(34.4)
<b>Total</b>	<b>549</b>	<b>395</b>	<b>282</b>	<b>410</b>	<b>473</b>
<b>Net Profit before EI</b>					
Utilities	16.6	8.5	4.1	6.0	6.0
Marine	(3.6)	1.4	1.4	1.7	2.8
Industrial Parks	421.3	472.2	660.1	336.7	171.7
Other Businesses and	(2.8)	(14.2)	(15.9)	(20.9)	(27.5)
<b>Total</b>	<b>5.8</b>	<b>5.0</b>	<b>3.6</b>	<b>4.1</b>	<b>4.3</b>

## Income Statement (\$\$m)

FY Dec	2015A	2016A	2017F	2018F	2019F
Revenue	9,545	7,907	7,760	9,914	10,875
Cost of Goods Sold	(8,813)	(6,802)	(6,649)	(8,760)	(9,637)
<b>Gross Profit</b>	<b>732</b>	<b>1,105</b>	<b>1,111</b>	<b>1,154</b>	<b>1,238</b>
Other Opng (Exp)/Inc	(950)	(349)	(349)	(373)	(398)
<b>Operating Profit</b>	<b>(218)</b>	<b>756</b>	<b>762</b>	<b>780</b>	<b>841</b>
Other Non Opng (Exp)/Inc	418	39.6	(7.8)	(7.8)	(7.8)
Associates & JV Inc	6.20	125	134	131	129
Net Interest (Exp)/Inc	(205)	(372)	(377)	(367)	(343)
Exceptional Gain/(Loss)	426	(12.1)	(92.7)	0.0	0.0
<b>Pre-tax Profit</b>	<b>426</b>	<b>537</b>	<b>418</b>	<b>536</b>	<b>619</b>
Tax	28.1	(100)	(105)	(95.6)	(115)
Minority Interest	94.5	(42.3)	(31.0)	(31.0)	(31.0)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
<b>Net Profit</b>	<b>549</b>	<b>395</b>	<b>281</b>	<b>410</b>	<b>473</b>
Net Profit before Except.	123	407	374	410	473
EBITDA	590	1,305	1,310	1,347	1,428
<b>Growth</b>					
Revenue Gth (%)	(12.4)	(17.2)	(1.9)	27.8	9.7
EBITDA Gth (%)	(63.4)	121.2	0.4	2.8	6.0
Opg Profit Gth (%)	(120.5)	(446.5)	0.7	2.4	7.7
Net Profit Gth (Pre-ex) (%)	(84.6)	230.1	(8.1)	9.5	15.3
<b>Margins &amp; Ratio</b>					
Gross Margins (%)	7.7	14.0	14.3	11.6	11.4
Opg Profit Margin (%)	(2.3)	9.6	9.8	7.9	7.7
Net Profit Margin (%)	5.8	5.0	3.6	4.1	4.3
ROAE (%)	9.1	6.0	4.2	5.9	6.4
ROA (%)	3.0	1.9	1.3	1.8	2.0
ROCE (%)	(1.5)	3.6	3.1	3.4	3.6
Div Payout Ratio (%)	35.8	36.2	32.0	32.0	32.0
Net Interest Cover (x)	(1.1)	2.0	2.0	2.1	2.4

Source: Company, DBS Bank



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

FY Dec	3Q2016	4Q2016	1Q2017	2Q2017	3Q2017
Revenue	2,140	2,026	2,140	2,275	1,808
Cost of Goods Sold	(1,841)	(1,776)	(1,899)	(1,950)	(1,576)
<b>Gross Profit</b>	<b>298</b>	<b>250</b>	<b>240</b>	<b>326</b>	<b>232</b>
Other Oper. (Exp)/Inc	(83.9)	(36.7)	(17.7)	(104)	(17.6)
<b>Operating Profit</b>	<b>214</b>	<b>214</b>	<b>223</b>	<b>222</b>	<b>214</b>
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	3.49	47.9	57.6	34.7	26.9
Net Interest (Exp)/Inc	(83.3)	(127)	(125)	(131)	(117)
Exceptional Gain/(Loss)	(46.2)	30.4	(5.2)	(33.9)	(53.6)
<b>Pre-tax Profit</b>	<b>88.3</b>	<b>165</b>	<b>150</b>	<b>91.4</b>	<b>70.3</b>
Tax	(30.0)	(12.2)	(14.9)	(31.9)	(28.1)
Minority Interest	(4.5)	(5.5)	(16.2)	(4.3)	(8.6)
<b>Net Profit</b>	<b>53.9</b>	<b>147</b>	<b>119</b>	<b>55.3</b>	<b>33.6</b>
Net profit bef Except.	100	117	124	89.2	87.2
EBITDA	218	262	280	257	241

**Growth**

Revenue Gth (%)	15.9	(5.3)	5.6	6.3	(20.6)
EBITDA Gth (%)	0.7	20.1	7.2	(8.5)	(6.0)
Opg Profit Gth (%)	20.3	(0.4)	4.3	(0.4)	(3.4)
Net Profit Gth (Pre-ex) (%)	5.7	16.9	6.2	(28.3)	(2.2)

**Margins**

Gross Margins (%)	13.9	12.4	11.2	14.3	12.8
Opg Profit Margins (%)	10.0	10.5	10.4	9.8	11.9
Net Profit Margins (%)	2.5	7.3	5.6	2.4	1.9

**Balance Sheet (\$\$m)**

FY Dec	2015A	2016A	2017F	2018F	2019F
Net Fixed Assets	8,685	11,226	11,804	12,360	12,894
Invt in Associates & JVs	2,349	1,746	1,810	1,871	1,930
Other LT Assets	1,273	1,694	1,694	1,694	1,694
Cash & ST Invt	1,609	1,887	1,084	2,292	3,247
Inventory	4,233	3,466	3,880	3,305	2,719
Debtors	1,568	1,958	1,724	1,803	1,673
Other Current Assets	201	317	317	317	317
<b>Total Assets</b>	<b>19,915</b>	<b>22,290</b>	<b>22,308</b>	<b>23,636</b>	<b>24,467</b>
ST Debt	1,801	2,126	2,126	2,126	2,126
Creditor	3,388	3,398	3,335	4,260	4,673
Other Current Liab	758	492	404	455	501
LT Debt	5,032	7,096	7,096	7,096	7,096
Other LT Liabilities	894	1,016	1,016	1,016	1,016
Shareholder's Equity	6,433	6,701	6,840	7,160	7,501
Minority Interests	1,610	1,461	1,492	1,523	1,554
<b>Total Cap. &amp; Liab.</b>	<b>19,915</b>	<b>22,290</b>	<b>22,308</b>	<b>23,636</b>	<b>24,467</b>
Non-Cash Wkg. Capital	1,856	1,852	2,183	709	(465)
Net Cash/(Debt)	(5,223)	(7,335)	(8,137)	(6,930)	(5,974)
Debtors Turn (avg days)	52.9	81.4	86.6	64.9	58.3
Creditors Turn (avg days)	132.8	193.0	197.3	166.7	177.8
Inventory Turn (avg days)	161.0	218.9	215.3	157.7	119.9
Asset Turnover (x)	0.5	0.4	0.3	0.4	0.5
Current Ratio (x)	1.3	1.3	1.2	1.1	1.1
Quick Ratio (x)	0.5	0.6	0.5	0.6	0.7
Net Debt/Equity (X)	0.6	0.9	1.0	0.8	0.7
Net Debt/Equity ex MI (X)	0.8	1.1	1.2	1.0	0.8
Capex to Debt (%)	20.2	8.8	10.8	10.8	10.8
Z-Score (X)	1.2	1.1	1.1	1.1	0.9

Source: Company, DBS Bank



## Cash Flow Statement (\$m)

FY Dec	2015A	2016A	2017F	2018F	2019F
Pre-Tax Profit	426	537	418	536	618
Dep. & Amort.	405	454	422	444	468
Tax Paid	(150)	(85.8)	(189)	(105)	(95.6)
Assoc. & JV Inc/(loss)	(6.2)	(125)	(134)	(131)	(129)
Chg in Wkg.Cap.	(1,961)	(395)	(247)	1,484	1,155
Other Operating CF	525	487	0.0	0.0	0.0
<b>Net Operating CF</b>	<b>(761)</b>	<b>872</b>	<b>269</b>	<b>2,228</b>	<b>2,017</b>
Capital Exp.(net)	(1,381)	(810)	(1,000)	(1,000)	(1,000)
Other Invt.(net)	9.98	0.0	0.0	0.0	0.0
Invt in Assoc. & JV	(427)	(60.9)	0.0	0.0	0.0
Div from Assoc & JV	129	122	70.0	70.0	70.0
Other Investing CF	471	(51.6)	0.0	0.0	0.0
<b>Net Investing CF</b>	<b>(1,199)</b>	<b>(801)</b>	<b>(930)</b>	<b>(930)</b>	<b>(930)</b>
Div Paid	(415)	(225)	(143)	(90.0)	(131)
Chg in Gross Debt	2,046	1,107	0.0	0.0	0.0
Capital Issues	0.0	0.0	0.0	0.0	0.0
Other Financing CF	261	(668)	0.0	0.0	0.0
<b>Net Financing CF</b>	<b>1,892</b>	<b>214</b>	<b>(143)</b>	<b>(90.0)</b>	<b>(131)</b>
Currency Adjustments	14.7	(35.0)	0.0	0.0	0.0
Chg in Cash	(53.0)	250	(803)	1,208	956
Opg CFPS (S cts)	67.3	70.9	28.9	41.6	N/A
Free CFPS (S cts)	(120)	3.46	(40.9)	68.7	N/A

Source: Company, DBS Bank

## Target Price &amp; Ratings History



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

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	24 Jan 17	3.27	3.10	BUY
2:	24 Feb 17	3.27	3.80	BUY
3:	06 Mar 17	3.30	3.80	BUY
4:	04 May 17	3.15	3.80	BUY
5:	23 May 17	3.19	3.80	BUY
6:	02 Jun 17	3.14	3.80	BUY
7:	20 Jul 17	3.24	4.10	BUY
8:	26 Jul 17	3.34	4.10	BUY
9:	04 Aug 17	3.18	4.00	BUY
10:	20 Sep 17	2.96	4.00	BUY
11:	09 Oct 17	3.11	4.00	BUY
12:	03 Nov 17	3.30	4.20	BUY

Source: DBS Bank

Analyst: Pei Hwa HO

# Singapore Company Guide

## Keppel Corporation

Version 11 | Bloomberg: KEP SP | Reuters: KPLM.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

22 Jan 2018

### BUY

Last Traded Price ( 19 Jan 2018): S\$8.25 (STI : 3,550.36)  
Price Target 12-mth: S\$10.30 (25% upside) (Prev S\$9.80)

#### Analyst

Pei Hwa HO +65 6682 3714 peihwa@db.com

### What's New

- Safer proxy to ride property and O&M re-rating
- Potential sale of six jackup rigs to Borr Drilling a confidence booster
- Reiterate BUY; TP raised to S\$10.30

#### Price Relative



#### Forecasts and Valuation

FY Dec (S\$ m)	2016A	2017F	2018F	2019F
Revenue	6,767	5,768	6,230	9,608
EBITDA	1,392	1,552	1,628	2,074
Pre-tax Profit	1,055	921	1,267	1,646
Net Profit	784	695	956	1,242
Net Pft (Pre Ex.)	784	1,265	956	1,242
Net Pft Gth (Pre-ex) (%)	(46.9)	61.4	(24.4)	29.9
EPS (S cts)	43.1	38.2	52.6	68.3
EPS Pre Ex. (S cts)	43.1	69.6	52.6	68.3
EPS Gth Pre Ex (%)	(47)	61	(24)	30
Diluted EPS (S cts)	43.0	38.1	52.4	68.1
Net DPS (S cts)	20.0	15.3	21.0	27.3
BV Per Share (S cts)	641	660	697	744
PE (X)	19.1	21.6	15.7	12.1
PE Pre Ex. (X)	19.1	11.9	15.7	12.1
P/Cash Flow (X)	45.4	10.3	18.2	13.5
EV/EBITDA (X)	16.1	13.9	13.1	10.1
Net Div Yield (%)	2.4	1.9	2.6	3.3
P/Book Value (X)	1.3	1.3	1.2	1.1
Net Debt/Equity (X)	0.5	0.5	0.4	0.4
ROAE (%)	6.9	5.9	7.8	9.5
Earnings Rev (%):		(38)	(2)	(1)
Consensus EPS (S cts):		45.2	51.3	56.1
Other Broker Recs:		B: 13	S: 1	H: 5

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

### A safer O&M play

**Reiterate BUY with higher TP of S\$ 10.30** after raising O&M valuation peg to 2.4x P/B multiple (1.8x previously), equivalent to 0.5SD below mean. Keppel is a safer bet to ride on property re-rating and O&M recovery. Keppel's decent dividend yield of 3-4% (based on 40% payout ratio) also lends support to its share price.

**Where we differ: Property's steep discount to RNAV poised to narrow.** Keppel's property segment remains undervalued at 0.9x P/B, below Singapore developers' 1.0x, notwithstanding Keppel's huge historical landbank of 6.5m sqm at lower cost. Half of the landbank is currently under development and expected to complete by 2020, with RNAV to be realised over the next 3-5 years. Out of its remaining undeveloped landbank, 40% is for development projects in Tianjin Eco-City, which Keppel acquired in 2009 at less than one-tenth of the current land price which is yet to be reflected in our RNAV. In addition, the ongoing portfolio rebalancing exercise will unlock values of completed projects. Hence, we believe the current steep 30% RNAV discount should narrow to ~10%, similar to peer Capitaland, pushing its share price closer to our highest-on-the-street TP of S\$10.30.

**O&M on the cusp of recovery.** O&M's contract wins in 2017 bucked the declining trend as the division clinched S\$1.1bn worth of new orders, which doubled over 2016. The momentum should continue into 2018 with S\$3bn new orders assumed. New orders are expected to come from gas and FPSO projects which are buoyed by sustained oil prices above US\$60/bbl. The recovery of new orders towards our assumption could prompt further re-rating of the O&M business.

#### Valuation:

Our TP of S\$ 10.30 is based on sum-of-parts valuation: (1) O&M segment is valued at 2.4x P/B, (2) infrastructure at 15x PE on FY18F earnings, (3) property segment at 1.35x P/BV, (4) investment (Keppel Capital) at 15x FY18F earnings, and (5) market values/estimated fair values are used for listed subsidiaries. Our TP translates to 1.3x FY18 P/B.

#### Key Risks to Our View:

**O&M segment could fare worse than expected.** We forecast annual revenues from Keppel O&M to fall to the ~S\$2.6bn level in FY17 and FY18, from S\$7-8bn during FY12-14. The continued depletion of its orderbook and deferments/cancellations could pose downside risks to our forecast.

#### At A Glance

Issued Capital (m shrs)	1,813
Mkt. Cap (S\$m/US\$m)	14,959 / 11,327
Major Shareholders (%)	
Temasek Holdings Private Ltd	20.5
Blackrock	5.0
Blackrock	4.7
Free Float (%)	74.5
3m Avg. Daily Val (US\$m)	26.1
ICB Industry : Oil & Gas / Oil Equipment, Services & Dist	

## WHAT'S NEW

### Potential sale of six rigs to Borr

**Keppel disposing six jackup rigs to Borr.** Keppel confirmed the Business Times article in relation to a possible sale of six jackup rigs to Borr Drilling. The discussions are ongoing and terms have yet to be finalised. Assuming the total transaction value of US\$960m reported in the article is true, it implies a price tag of US\$160m per rig. This represents approx. 25% discount to

original contract value of c.US\$215m. In view of the 20% downpayment collected from customer and potential 5-10% margin, we believe the P&L impact should be minimal. Nevertheless, this is very positive news as it removes a key overhang of undelivered rigs. We believe eight out of 17 undelivered jackup rigs are at higher risk of seeing cancellations.

### Keppel's undelivered rigs

Type	Date announced	Type of rig / vessel	Contract value (US\$ m)	Contract Value, (\$ m)	Original Delivery	Rescheduling	Customer
<b>SEMI-SUBMERSIBLES</b>							
Semi-sub	22-Dec-11	DSS 38E semisubmersible rig	809	1,043.6	4Q15	Deferred	Sete Brasil
Semi-sub	7-Aug-12	DSS 38E semisubmersible rig	824	1,030.0	4Q16	Deferred	Sete Brasil
Semi-sub	7-Aug-12	DSS 38E semisubmersible rig	824	1,030.0	3Q17	Deferred	Sete Brasil
Semi-sub	7-Aug-12	DSS 38E semisubmersible rig	824	1,030.0	2Q18	Deferred	Sete Brasil
Semi-sub	7-Aug-12	DSS 38E semisubmersible rig	824	1,030.0	4Q18	Deferred	Sete Brasil
Semi-sub	7-Aug-12	DSS 38E semisubmersible rig	824	1,030.0	3Q19	Deferred	Sete Brasil

<b>JACK-UPS</b>							
Jackup	21-Nov-13	KFELS Super A class	265.0	330.5	2Q16	2Q18	Ensco PLC
Jackup	28-Mar-13	KFELS B Class	205	254.7	3Q15	4Q17	Grupo R
Jackup	28-Mar-13	KFELS B Class	205	254.7	4Q15	4Q17	Grupo R
Jackup	15-Jul-13	KFELS B Class	206	260.0	4Q15	4Q17	Grupo R
Jackup	2-Aug-13	KFELS B Class	206	261.6	4Q15	4Q17	Parden
Jackup	1-Oct-13	KFELS B Class	220	276.3	4Q15	4Q17	Clearwater
Jackup	1-Oct-13	KFELS B Class	220	276.3	1Q16	4Q17	Falcon
Jackup	3-Mar-14	KFELS N class plus	500	633.9	1Q17	4Q17	TS Offshore
Jackup	13-Feb-14	KFELS B class	217	274.3	3Q16	3Q19	Fecon
Jackup	13-Feb-14	KFELS B class	217	274.3	4Q16	3Q19	Fecon
Jackup	13-Feb-14	KFELS B class	217	274.3	4Q16	3Q19	Fecon
Jackup	7-Nov-13	KFELS Super B class	220	273.5	1Q16	1Q18	Borr Drilling
Jackup	7-Nov-13	KFELS Super B class	220	273.5	2Q16	2Q18	Borr Drilling
Jackup	7-Nov-13	KFELS Super B class	220	273.5	4Q16	2Q19	Borr Drilling
Jackup	7-Nov-13	KFELS Super B class	220	273.5	1Q17	2Q20	Borr Drilling
Jackup	7-Nov-13	KFELS Super B class	220	273.5	3Q17	4Q20	Borr Drilling
Jackup	31-Oct-14	KFELS Super B class	240	306.8	4Q16	1Q19	BOT Lease

\*Highlighted ones are projects at higher risks of cancellations in our view

Source: Company, DBS Bank

## Keppel's SOTP-based valuation

	Value (\$ m)	Metrics
<b>Market value of listed entities</b>	<b>1,332</b>	
Less: book value	1,105	
<b>Surplus from listed associates (1)</b>	<b>227</b>	
Surplus - Property (2)	2,866	1.35x P/Bv, less book value; Tianjin Eco-city land sale
Surplus - Offshore/Marine (3)	2,179	2.4x P/BV, less book value
Surplus - Infrastructure (4)	(79)	15x FY17 net profit, less book value
Surplus - Investment (5)	346	15x FY17 net profit, less book value
<b>Net Surplus (Listed and unlisted entities) (1+2+3+4+5)</b>	<b>5,539</b>	
Add: Book value (less minorities) as of 3Q17	11,919	
<b>RNAV</b>	<b>17,459</b>	
<b>RNAV per share (\$)</b>	<b>10.30</b>	

Source: Company, DBS Bank

## CRITICAL DATA POINTS TO WATCH

### Critical Factors

**Orderbook the key driver of Keppel O&M's earnings; FLNG and production facilities to fill the gap.** Keppel O&M is on the cusp of recovery, seeing stronger order flows as it clinched S\$1.1bn in new orders in FY17, from S\$500m in FY16. We expect the momentum to accelerate in 2018, with higher order win expectation of S\$2.5bn. We believe the pick-up in demand for O&G production related facilities and FLNG vessels in the next 2-3 years could eventually drive contract wins closer to the norm of S\$4-6bn p.a. This would buck the declining trend of its current low orderbook of S\$3.9bn (excl S\$4bn of Sete orders). Scrapping of old rigs (>30 years old), estimated to constitute ~15% of the current fleet globally, could help push the market back into balance. An oil price rebound would also improve rig utilisation, spurring capex spend and order wins. In terms of growth potential, Keppel's first-mover advantage in the FLNG conversion market could provide earnings upside; customer Golar has already awarded Keppel a third FLNG project.

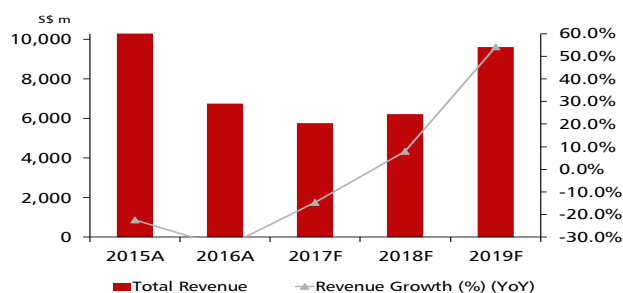
**Residential property sales in China and Vietnam are the main drivers of Keppel Land's revenue and earnings.** In China, further relaxation of cooling measures, urbanisation and low mortgage rates resulting from monetary easing, seem to be encouraging for residential property sales. Vietnam is another emerging market for Keppel, accounting for 27% of its home sales in 9M17. Our property analyst believes that Singapore property market is at the start of a multi-year upturn with strong rebound in transaction volumes in 2018.

**Infrastructure division's earnings buoyed by handover of problematic assets.** The bad apple situation with Keppel Infrastructure's EPC projects has improved with the handover of the two Greater Manchester EfW (energy-from-waste) plants and Doha North in 2015. Thus, lower EPC provisions going forward should boost earnings in the short term.

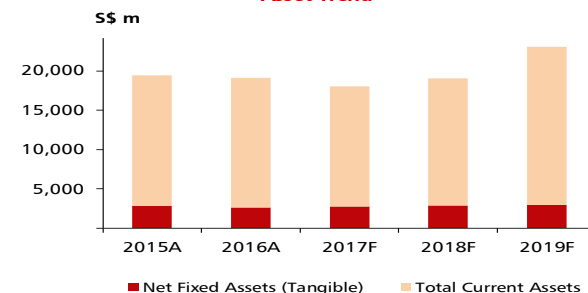
### Value unlocking divestments can provide earnings upside.

Divestments can free up cash to be invested in more profitable areas or to pay down debt. M1 is a possible candidate for sale; its fundamentals are uninspiring and our telecom analyst has downgraded M1 to FULLY VALUED after removing the 25% M&A premium from its DCF valuation, following the announcement that M1's major shareholders (with a combined stake of 61%) are not going ahead with a strategic review to dispose of their stake. We estimate Keppel's stake in M1 to be worth ~S\$320m. Injection of infrastructure assets such as Woodlands Wafer Fab Park into Keppel Infrastructure Trust (KIT), to whom Keppel Infrastructure acts as sponsor, could be another alternative.

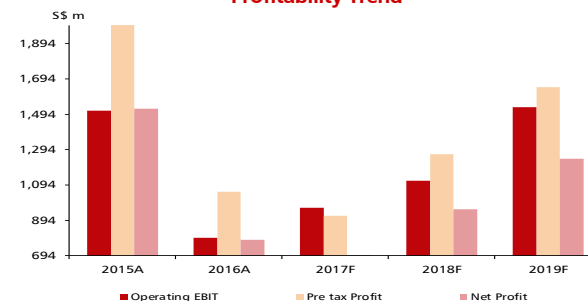
Sales Trend



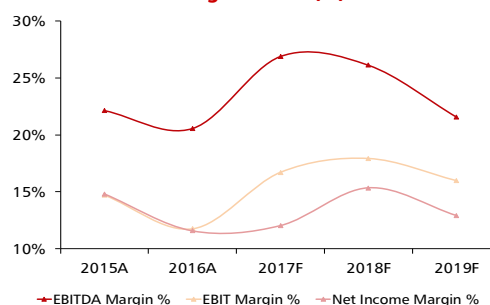
Asset Trend



Profitability Trend



Margin Trends (%)



Source: Company, DBS Bank

**Balance Sheet:**

Following the privatisation of Keppel Land in 1Q15, Keppel Corp's net gearing rose from 0.11x as of end-2014 to 0.42x as of end-2Q15 and 0.662x as of end-2Q16. The increase in gearing stemmed from lower shareholders' equity and cash balance as the privatisation was largely funded by cash. The gearing level had since declined to 0.5x as of end-3Q17, aided by capital recycling.

**Share Price Drivers:**

**Recovery in oil prices to support the share price.** We think Keppel O&M will benefit from oil prices staying above US\$60/bbl, which should trigger more offshore oil & gas capex spend.

**Announcement of new order wins.** Strong order win announcements could push up the share price, as investors reward greater visibility on revenues and earnings.

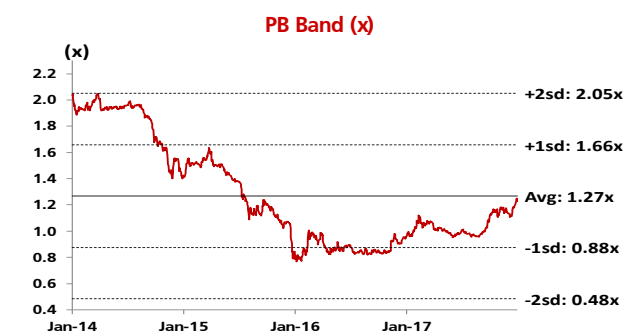
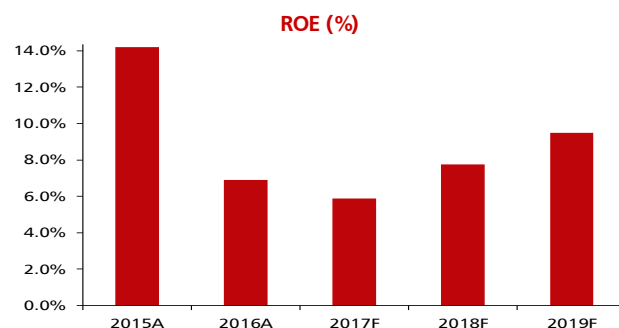
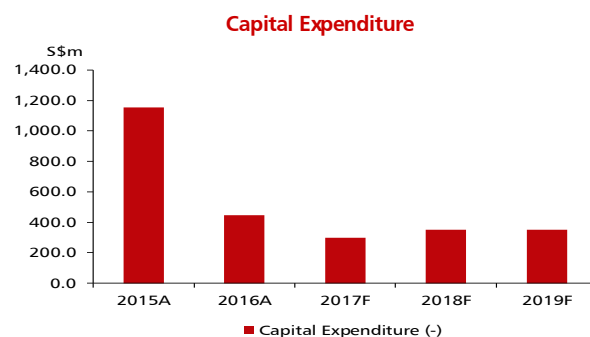
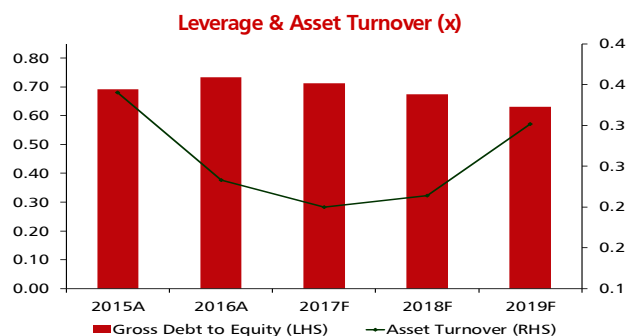
**Key Risks:**

**Competition from foreign yards.** 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.

**Further deferments possible if oil prices remain subdued.** Since the oil price started declining in mid-2014, we have seen oil majors and asset owners slash capex spending substantially, which has hit yards hard. Meanwhile, deliveries of newbuilds and conversions already under construction are being delayed – a situation which could worsen if oil prices remain low.

**Company Background**

Keppel is a diversified conglomerate with its core businesses in offshore marine (O&M), property investments and development, and infrastructure-based activities in Singapore and the region. O&M is the largest segment, typically contributing about two-thirds of group revenue. It possesses strong market leadership positions in rigbuilding, particularly for jackups and semi-submersibles, FPSO conversion, FLNG conversion, as well as repair and construction of high-end specialised vessels.



Source: Company, DBS Bank

### Key Assumptions

FY Dec	2015A	2016A	2017F	2018F	2019F
O&M order wins (\$\$ m)	1,773	500	1,500	3,000	0.0

### Segmental Breakdown

FY Dec	2015A	2016A	2017F	2018F	2019F
<b>Revenues (\$\$m)</b>					
Offshore and Marine	6,241	2,854	2,115	2,177	4,683
Property	1,926	2,035	1,533	1,814	2,591
Infrastructure	2,058	1,744	1,957	2,059	2,144
Investments	71.1	134	164	181	190
<b>Total</b>	<b>10,296</b>	<b>6,767</b>	<b>5,768</b>	<b>6,230</b>	<b>9,608</b>
<b>EBIT (\$\$m)</b>					
Offshore and Marine	597	135	271	281	502
Property	636	505	414	472	648
Infrastructure	221	93.8	98.0	113	118
Investments	45.6	48.4	181	251	268
Others	14.1	13.3	0.0	0.0	0.0
<b>Total</b>	<b>1,514</b>	<b>795</b>	<b>964</b>	<b>1,117</b>	<b>1,535</b>
<b>EBIT Margins (%)</b>					
Offshore and Marine	9.6	4.7	12.8	12.9	10.7
Property	33.0	24.8	27.0	26.0	25.0
Infrastructure	10.7	5.4	5.0	5.5	5.5
Investments	64.2	36.1	110.5	138.9	141.3
Others	N/A	N/A	N/A	N/A	N/A
<b>Total</b>	<b>14.7</b>	<b>11.8</b>	<b>16.7</b>	<b>17.9</b>	<b>16.0</b>

### Income Statement (\$\$m)

FY Dec	2015A	2016A	2017F	2018F	2019F
Revenue	10,296	6,767	5,768	6,230	9,608
Cost of Goods Sold	(7,023)	(4,204)	(3,507)	(3,780)	(6,248)
<b>Gross Profit</b>	<b>3,273</b>	<b>2,563</b>	<b>2,262</b>	<b>2,450</b>	<b>3,361</b>
Other Opng (Exp)/Inc	(1,760)	(1,768)	(1,298)	(1,333)	(1,826)
<b>Operating Profit</b>	<b>1,514</b>	<b>795</b>	<b>964</b>	<b>1,117</b>	<b>1,535</b>
Other Non Opg (Exp)/Inc	15.0	15.2	11.5	12.5	19.2
Associates & JV Inc	504	345	375	300	250
Net Interest (Exp)/Inc	(35.5)	(100)	(149)	(162)	(158)
Exceptional Gain/(Loss)	0.0	0.0	(280)	0.0	0.0
<b>Pre-tax Profit</b>	<b>1,997</b>	<b>1,055</b>	<b>921</b>	<b>1,267</b>	<b>1,646</b>
Tax	(404)	(233)	(193)	(266)	(346)
Minority Interest	(68.3)	(37.9)	(32.7)	(45.1)	(58.5)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
<b>Net Profit</b>	<b>1,525</b>	<b>784</b>	<b>695</b>	<b>956</b>	<b>1,242</b>
Net Profit before Except.	1,476	784	1,265	956	1,242
EBITDA	2,280	1,392	1,552	1,628	2,074
<b>Growth</b>					
Revenue Gth (%)	(22.5)	(34.3)	(14.8)	8.0	54.2
EBITDA Gth (%)	(27.7)	(39.0)	11.5	4.9	27.3
Opg Profit Gth (%)	(36.2)	(47.5)	21.2	15.9	37.5
Net Profit Gth (Pre-ex) (%)	2.2	(46.9)	61.4	(24.4)	29.9
<b>Margins &amp; Ratio</b>					
Gross Margins (%)	31.8	37.9	39.2	39.3	35.0
Opg Profit Margin (%)	14.7	11.8	16.7	17.9	16.0
Net Profit Margin (%)	14.8	11.6	12.0	15.3	12.9
ROAE (%)	14.2	6.9	5.9	7.8	9.5
ROA (%)	5.0	2.7	2.4	3.3	3.9
ROCE (%)	5.6	2.9	3.4	3.9	5.2
Div Payout Ratio (%)	40.4	46.3	40.0	40.0	40.0
Net Interest Cover (x)	42.6	7.9	6.5	6.9	9.7

Source: Company, DBS Bank

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

FY Dec	3Q2016	4Q2016	1Q2017	2Q2017	3Q2017
Revenue	1,459	1,940	1,248	1,554	1,617
Cost of Goods Sold	(917)	(1,214)	(824)	(1,042)	(1,035)
<b>Gross Profit</b>	<b>542</b>	<b>726</b>	<b>425</b>	<b>512</b>	<b>582</b>
Other Oper. (Exp)/Inc	(357)	(628)	(237)	(374)	(258)
<b>Operating Profit</b>	<b>186</b>	<b>98.0</b>	<b>187</b>	<b>139</b>	<b>324</b>
Other Non Opg (Exp)/Inc	2.31	4.90	2.77	1.72	11.2
Associates & JV Inc	122	143	170	96.6	45.4
Net Interest (Exp)/Inc	(23.9)	(40.5)	(13.5)	(19.6)	(17.5)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
<b>Pre-tax Profit</b>	<b>286</b>	<b>206</b>	<b>347</b>	<b>217</b>	<b>363</b>
Tax	(60.8)	(54.7)	(76.4)	(62.7)	(71.7)
Minority Interest	(1.1)	(8.2)	(10.0)	5.59	0.28
<b>Net Profit</b>	<b>225</b>	<b>143</b>	<b>260</b>	<b>160</b>	<b>292</b>
Net profit bef Except.	225	143	112	173	292
EBITDA	363	316	416	294	431

## Growth

Revenue Gth (%)	(10.3)	33.0	(35.7)	24.5	4.0
EBITDA Gth (%)	0.8	(13.0)	31.8	(29.3)	46.6
Opg Profit Gth (%)	(20.5)	(47.2)	91.1	(26.0)	133.8
Net Profit Gth (Pre-ex) (%)	(364.1)	(36.3)	(21.5)	54.2	68.6

## Margins

Gross Margins (%)	37.2	37.4	34.0	33.0	36.0
Opg Profit Margins (%)	12.7	5.1	15.0	8.9	20.0
Net Profit Margins (%)	15.4	7.4	20.9	10.3	18.0

## Balance Sheet (\$\$m)

FY Dec	2015A	2016A	2017F	2018F	2019F
Net Fixed Assets	2,846	2,645	2,744	2,894	2,975
Invt in Associates & JVs	5,410	5,315	5,640	5,890	6,089
Other LT Assets	4,081	4,807	4,807	4,807	4,807
Cash & ST Invt	2,118	2,361	3,198	3,442	3,867
Inventory	10,763	10,026	8,546	8,900	10,676
Debtors	3,141	3,450	2,941	3,176	4,898
Other Current Assets	563	630	630	630	630
<b>Total Assets</b>	<b>28,921</b>	<b>29,234</b>	<b>28,505</b>	<b>29,739</b>	<b>33,943</b>
ST Debt	857	1,835	1,835	1,835	1,835
Creditor	4,972	4,753	4,052	4,376	6,749
Other Current Liab	2,954	2,582	2,190	2,376	3,289
LT Debt	7,402	7,218	7,218	7,218	7,218
Other LT Liabilities	811	512	512	512	512
Shareholder's Equity	11,096	11,659	11,991	12,669	13,528
Minority Interests	830	675	707	752	811
<b>Total Cap. &amp; Liab.</b>	<b>28,921</b>	<b>29,234</b>	<b>28,505</b>	<b>29,739</b>	<b>33,943</b>
Non-Cash Wkg. Capital	6,541	6,770	5,875	5,954	6,166
Net Cash/(Debt)	(6,141)	(6,692)	(5,855)	(5,611)	(5,186)
Debtors Turn (avg days)	100.2	177.7	202.2	179.2	153.4
Creditors Turn (avg days)	284.2	447.3	486.2	429.5	339.6
Inventory Turn (avg days)	577.5	956.2	1,025.5	889.1	597.6
Asset Turnover (x)	0.3	0.2	0.2	0.2	0.3
Current Ratio (x)	1.9	1.8	1.9	1.9	1.7
Quick Ratio (x)	0.6	0.6	0.8	0.8	0.7
Net Debt/Equity (X)	0.5	0.5	0.5	0.4	0.4
Net Debt/Equity ex MI (X)	0.6	0.6	0.5	0.4	0.4
Capex to Debt (%)	14.0	4.9	3.3	3.9	3.9
Z-Score (X)	1.9	1.7	1.7	1.8	1.7

Source: Company, DBS Bank



### Cash Flow Statement (S\$m)

FY Dec	2015A	2016A	2017F	2018F	2019F
Pre-Tax Profit	1,997	1,055	921	1,267	1,646
Dep. & Amort.	247	236	202	199	269
Tax Paid	(302)	(223)	(339)	(193)	(266)
Assoc. & JV Inc/(loss)	(504)	(345)	(375)	(300)	(250)
Chg in Wkg.Cap.	(1,801)	(643)	1,041	(151)	(292)
Other Operating CF	(422)	250	0.0	0.0	0.0
<b>Net Operating CF</b>	<b>(786)</b>	<b>330</b>	<b>1,450</b>	<b>822</b>	<b>1,107</b>
Capital Exp.(net)	(1,153)	(447)	(300)	(350)	(350)
Other Invt.(net)	0.0	0.0	0.0	0.0	0.0
Invt in Assoc. & JV	(330)	(151)	(150)	(150)	(149)
Div from Assoc & JV	351	404	200	200	200
Other Investing CF	1,339	(115)	0.0	0.0	0.0
<b>Net Investing CF</b>	<b>207</b>	<b>(310)</b>	<b>(250)</b>	<b>(300)</b>	<b>(299)</b>
Div Paid	(956)	(622)	(363)	(278)	(382)
Chg in Gross Debt	924	817	0.0	0.0	0.0
Capital Issues	8.89	1.13	0.0	0.0	0.0
Other Financing CF	(3,269)	(29.5)	0.0	0.0	0.0
<b>Net Financing CF</b>	<b>(3,292)</b>	<b>167</b>	<b>(363)</b>	<b>(278)</b>	<b>(382)</b>
Currency Adjustments	28.1	7.10	0.0	0.0	0.0
Chg in Cash	(3,843)	194	837	244	426
Opg CFPS (S cts)	55.9	53.5	22.5	53.5	77.0
Free CFPS (S cts)	(107)	(6.4)	63.2	26.0	41.7

Source: Company, DBS Bank

### Target Price & Ratings History



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

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	27 Jan 17	6.27	6.00	HOLD
2:	20 Feb 17	6.64	6.00	HOLD
3:	27 Feb 17	6.93	6.00	HOLD
4:	13 Mar 17	6.75	6.00	HOLD
5:	20 Mar 17	6.85	6.00	HOLD
6:	21 Mar 17	6.83	6.00	HOLD
7:	21 Apr 17	6.56	6.00	HOLD
8:	16 May 17	6.54	6.00	HOLD
9:	20 Jul 17	6.53	7.60	BUY
10:	26 Jul 17	6.52	7.60	BUY
11:	18 Aug 17	6.33	7.60	BUY
12:	24 Aug 17	6.36	7.60	BUY
13:	20 Sep 17	6.37	7.60	BUY
14:	09 Oct 17	6.75	7.60	BUY
15:	08 Jan 18	7.80	9.80	BUY

Source: DBS Bank

Analyst: Pei Hwa HO

DBS Bank recommendations are based on 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*

Completed Date: 22 Jan 2018 20:37:51 (SGT)

Dissemination Date: 22 Jan 2018 21:20:46 (SGT)

Sources for all charts and tables are DBS Bank unless otherwise specified.

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