Singapore Industry Focus

Singapore Rigbuilders

Refer to important disclosures at the end of this report

DBS Group Research . Equity

6 Mar 2018

Glimmer of hope for rig market

- Petrobras and Sete Brasil close to settlement
- Keppel-Awilco could potentially ink first newbuild rig contract in 2.5 years, worth up to S$2.3bn
- Borr consolidating the fragmented jackup market
- Reiterate BUY on Sembcorp Marine, Keppel

Buy on dips. Keppel and Sembcorp Marine (SMM) have **given back their gains** since the year started, alongside weaknesses in broad market and oil price as well as earnings disappointment. This presents a **good entry point** to position for strong contract flow ahead. We reiterate our stance that earnings are lagging indicators and contract wins are key catalysts during recovery. We believe healthy oil price above US$60 per barrel bodes well for project Final Investment Decision (FIDs), leading to **crytallisation of orders for production related platforms** (refer to table on the right for order win expectations; Sembcorp Marine: Energean FPSO contract in the bag?). **SMM remains our top pick** to ride O&G recovery with its strong visible order pipeline while **Keppel is a safer bet** backed by its multi-pronged business strategy.

Petrobras reportedly ready to settle with Sete Brasil. Petrobras and Sete have reportedly reached agreement on the charter of four drilling rigs, likely to be two each from Keppel and SMM. While market was expecting more deliveries (four rigs from each yard), the settlement should remove an overhang. The actual financial impact is dependent on: 1) rig price and payment agreed to complete those units; 2) any compensation on the receivables payable to shipyards; and 3) plans on the other four half-built units. In the broader scheme of things, we see the Petrobras-Sete rig deal as another positive indicator of demand recovery.

Keppel-Awilco's LOI a glimmer of light for newbuild rig demand. Keppel's Letter of Intent (LOI) with Awilco Drilling PLC (Awilco) to build a harsh environment semi-submersible with options to build up to a further three units at a price tag of US$425m each, has given rise to hopes of a revival for newbuild rigs.

Borr continues to consolidate jackup market. Borr proposed to buy its rival Paragon Offshore for US$232.5m at end Feb in a push to consolidate the fragmented rig market. It is also believed to be in talks to acquire six jackup rigs from Keppel.

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STOCKS

	Price S$	Mkt Cap US$m	12-mth Target Price S$	Performance (%) 3 mth	12 mth	Rating
Keppel Corporation	7.63	10,483	10.20	(1.8)	6.4	BUY
Sembcorp Industries	3.02	4,088	4.40	(1.0)	(8.2)	BUY
Sembcorp Marine	1.90	3,009	2.90	(1.0)	(6.4)	BUY

Source: DBS Bank, Bloomberg Finance L.P.
Closing price as of 5 Mar 2018

Potential order wins

Sembcorp Marine		
Type	Potential Customer / Project	Est.value (S$ 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
Newbuild FPSO	Energean	400
Modularised LNG Importing Terminal	-	200-300
FPSO conversion	-	200-300
		3,000-3,600

Keppel O&M		
Type	Potential Customer / Project	Est.value (S$ m)
FPSO conversion x4	Petrobras, Modec and others	600-800
LNG containership x2	Pasha Hawaii	500
Semi-submersible rig	Awilco	560
Semisub Production Unit	-	300-400
Specialised vessels (LNG carriers, Dredgers) x4	-	200
FLNG	-	900
		3,060-3,360

Source: Various sources, Company, DBS Bank

Petrobras – Sete reaches rig deal

On 1 Mar, Upstream reported that Petrobras and Sete Brasil (Sete) have reached an agreement on the construction and delivery of four drilling rigs while terminating contracts for another 24 rigs. While the units to be delivered were not disclosed, they are believed to be the ones near completion, likely to be the first two rigs each from Keppel and SMM.

Sete originally ordered the construction of 29 rigs in 2013 – one on speculation with five Brazilian shipyards. Of which, Keppel secured six semi-submersible rig contracts (US$6.2bn in total) while SMM won seven drillships (US$7bn in total).

Each of the four rigs will be chartered for a 10-year period at a day rate of US$299,000, which is a 13-16% discount from initial indicative day rates of between US$344,000 and US$357,000.

Will shipyards be able to write-back some of the provisions? Keppel and SMM collected substantial payments of c.S$4.4bn collectively and made provisions of c.S$640m to account for the shortfall i.e. receivables owed to the yards. We believe some compensation should be made to shipyards as an incentive to deliver the units. In addition, additional investments of ~S$300-400m will be required to complete the units.

Actual financial impact is dependent on 1) rig price and payment agreed to complete those units; 2) any compensation on the receivables payable to shipyards; and 3) plans on the other four half-built units.

In the broader scheme of things, we see the Petrobras-Sete rig deal as another positive indicator of demand recovery.

Details on Sete Brasil contracts awarded to Singapore rigbuilders

Original contract value	S$ bn	Remarks
Keppel	6.2	Six semi-submersible rigs
SMM	7.0	Seven drillships
WIP (>10% completion)	units	
Keppel	4 rigs	91%; 70%; 40%; 21%
SMM	4 rigs	>90%; 70%+; 65%; 33%
Payment collected from Sete Brasil	S$ bn	
Keppel	1.7	
SMM	2.7	
Provisions	S$ bn	
Keppel	*0.311*	4Q15; 4Q17
SMM	*0.329*	4Q15
Outstanding orderbook (from Sete Brasil)	S$ bn	
Keppel	4.0	
SMM	3.1	
Outstanding orderbook (Total)	S$ bn	
Keppel	7.9	
% Sete Brasil	*50.6%*	
SMM	7.58	
% Sete Brasil	*40.9%*	

Source: Companies, DBS Bank

Borr Drilling leading the jackup consolidation

Borr Drilling Limited (Borr), founded in Aug 2016 by John Fredriksen's ex-associate Tor Olav Troim and listed on Oslo at end-Aug 2017, has built up a fleet of 26 premium jack-ups at an average acquisition price of US$120m/rig, in three rig deals involving Transocean, bankrupt Hercules Offshore, and Sembcorp Marine

Takeover of Paragon makes Borr the largest premium jackup player. On 22 Feb, Borr Drilling announced a takeover offer to buy out Paragon Offshore for US$232.5m. The acquisition will add 10 jackups (the other 21 older jackups are likely to be scrapped) and 1 semi-submersible to Borr's existing fleet of 26 premium jackups.

In talks to acquire six newbuild jackup rigs from Keppel. Keppel confirmed that it is in discussion with Borr Drilling on possible sale of jackup rigs. According to Business Times article in Jan-2018, Borr Drilling could pontentially acquire six jackup rigs from keppel.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. 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.

Jackup up consolidation accelerates sector recovery. The acceleration of scrappage, coupled with improving rig demand is expected to lift the utilisation and day rates of rigs towards 2019, driving demand for newbuild rigs.

Awilco on the verge of awarding semisubmersible contract to Keppel

On 28 Feb, Keppel announced that it has signed a LOI with Awilco Drilling PLC (Awilco) to **build a harsh environment semisubmersible** with **options to build up to a further three** units. Based on Awilco's announcement (http://awilcodrilling.com/4142-Financial-News-Message?msg=http://cws.huginonline.com/A/147077/PR/201802/2171967.xml), the rig is valued at **US$425m each (approx S$560m).**

The contract is pending finalisation of terms and downpayment, but should be firmed up pretty soon given the planned delivery in 2021. Awilco has also proceeded to propose an equity raising exercise of US$65m through private placement to partial fund the payment for the newbuild contract. The payment term will likely be back-loaded in the ratio 10:10:80.

Contract value appears to be lower than usual price tag of US$500m and above for harsh environment semisubmersible rigs, as these are for mid-water segment which require lower specification than deepwater units. While margins might not be lucrative given the keener competition, raising the yard activity level and orderbook visibility are critical to maximise efficiency and profitability of the shipyards.

Nevertheless, this is very positive news for Keppel, marking a good start to the year. If Awilco exercises the options, the **total contract value could go up to US$1.7bn** (c. S$2.3bn). We have assumed S$3bn contract wins for Keppel in 2018.

Signs of rigbuilding comeback? Half a loaf is better than none. We do not expect newbuild rig demand to make a big comeback so soon as the market will need to see an acceleration in old rig scrapping and further improvement in rig chartering activity. However, we do see signs of revived interests on newbuild rigs. The bright spots are harsh environment drilling rigs especially for the mid-water segment, as supply is relatively scarce. In addition, there is an advantage of newbuild rigs - the flexibility to customise specifications for more cost saving solutions given the moderate oil price environment and the tendency of over-specifications for rigs that were ordered during the boom.

Singapore Rigbuilders: Order win expectations

Sembcorp Marine				Keppel O&M			
Type	Potential Customer / Project	Est.value (S$ m)	Status	Type	Potential Customer / Project	Est.value (S$ 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	Semi-submersible rig	Awilco	560	LOI
FPSO	Energean	400	Tender	Semisub Production Unit	-	300-400	Tender
Modularised LNG Importing Terminal	-	200-300	-	Specialised vessels (LNG carriers, Dredgers) x4	-	200	-
FPSO conversion	-	200-300	-	FLNG	-	900	-
		3,000-3,600				3,060-3,360	

Source: Various sources, Company, DBS Bank

Peer comparisons

Company	Market cap (US$m)	P/E FY18F	P/E FY19F	EV/EBITDA FY18F	EV/EBITDA FY19F	P/B Current	ROE (%) FY18F	ROE (%) FY19F	Net D/E Current	Div Yld (%) Current
Keppel Corp	10,503	14.2x	13.0x	15.6x	14.0x	1.2x	8.0%	8.5%	0.44x	2.6%
Hyundai Heavy Industries	7,395	339.8x	37.1x	17.5x	11.2x	0.7x	0.2%	2.0%	0.33x	nm
Yangzijiang	4,036	10.8x	11.0x	4.7x	4.8x	1.0x	9.2%	8.4%	CASH	0.0x
Shanghai Zhenhua Heavy Industries	3,209	65.1x	32.3x	12.9x	11.2x	1.6x	2.2%	4.9%	1.49x	1.9%
Sembcorp Marine	3,106	56.0x	35.6x	20.5x	17.8x	1.7x	2.5%	4.3%	1.11x	1.0%
Samsung Heavy Industries	2,916	nm	29.4x	65.1x	12.8x	0.5x	nm	1.9%	0.55x	nm
Daewoo Shipbuilding	2,529	1.6x	10.7x	4.8x	15.7x	0.6x	55.2%	5.6%	9.52x	nm
	Average:	**81.3x**	**24.2x**	**20.2x**	**12.5x**	**0.9x**	**10.7%**	**5.1%**	**3.01x**	**2.1%**
	Median:	**35.1x**	**29.4x**	**15.6x**	**12.8x**	**0.8x**	**2.5%**	**4.9%**	**1.11x**	**2.2%**

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

COMPANY GUIDES

Keppel Corporation

Version 12 | Bloomberg: KEP SP | Reuters: KPLM.SI

DBS Group Research . Equity

26 Jan 2018

BUY

Last Traded Price (25 Jan 2018): S$8.58 (**STI :** 3,572.62)
Price Target 12-mth: S$10.20 (19% upside) (Prev S$10.30)

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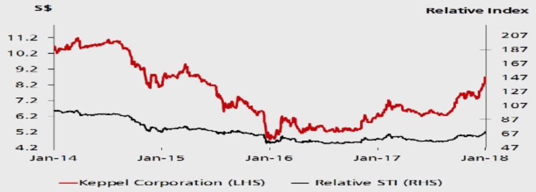
What's New

- FY17 below due to further provisions and impairments on O&M
- O&M in the red but outlook is improving with stronger enquiry levels
- Steady contribution from Tianjin Eco-City land sale
- Reiterate BUY; TP adjusted slightly to S$10.20

Price Relative



Forecasts and Valuation

FY Dec (S$ m)	2016A	2017A	2018F	2019F
Revenue	6,767	5,964	6,121	9,003
EBITDA	1,392	1,398	1,625	2,040
Pre-tax Profit	1,055	516	1,329	1,647
Net Profit	784	217	1,002	1,242
Net Pft (Pre Ex.)	784	835	1,002	1,242
Net Pft Gth (Pre-ex) (%)	(46.9)	6.6	20.0	23.9
EPS (S cts)	43.1	11.9	55.1	68.3
EPS Pre Ex. (S cts)	43.1	45.9	55.1	68.3
EPS Gth Pre Ex (%)	(47)	7	20	24
Diluted EPS (S cts)	43.0	11.9	55.0	68.1
Net DPS (S cts)	20.0	22.0	22.1	27.3
BV Per Share (S cts)	641	629	662	708
PE (X)	19.9	72.0	15.6	12.6
PE Pre Ex. (X)	19.9	18.7	15.6	12.6
P/Cash Flow (X)	47.3	11.3	247.2	12.1
EV/EBITDA (X)	16.5	15.3	13.6	10.6
Net Div Yield (%)	2.3	2.6	2.6	3.2
P/Book Value (X)	1.3	1.4	1.3	1.2
Net Debt/Equity (X)	0.5	0.4	0.5	0.4
ROAE (%)	6.9	1.9	8.5	10.0
Earnings Rev (%):		(69)	5	0
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

Out of the woods

Reiterate BUY with TP of S$ 10.20. FY17 earnings were below expectations due to further provisions for Sete projects and asset impairments that amounted to S$135m in total. Our TP is adjusted down slightly after factoring in the lower O&M book value. Keppel is a safer bet to ride on property re-rating and O&M recovery. Keppel's decent dividend yield of 3% (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, notwithstanding Keppel's huge historical landbank of 6.5m sqm held at a low cost. Half of the landbank is currently under development, realising its RNAV 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$10.20.

O&M on the cusp of recovery. O&M's contract wins in 2017 bucked the declining trend as the division clinched S$1.2bn 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$ 10.20 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$2-4bn level in FY18-19, from S$7-8bn during FY12-14. If contract flows do not come through as expected, continued depletion of its orderbook could pose downside risks to our forecast.

At A Glance

Issued Capital (m shrs)	1,813
Mkt. Cap (Sm/USm)	15,558 / 11,873
Major Shareholders (%)	
Temasek Holdings Private Ltd	20.5
Blackrock	5.0
Blackrock	4.7
Free Float (%)	74.5
3m Avg. Daily Val (US$m)	27.0

ICB Industry : Oil & Gas / Oil Equipment, Services & Dist

WHAT'S NEW

A kitchen sinking 2017

One-off financial penalty totalled S$619m, consists of S$570m financial penalty as announced, plus an additional S$49m of related legal, accounting and forensics costs.

Excluding these one-off items, Keppel would have achieved a net profit of S$836m. This represents 7% increase y-o-y, underpinned by growth from property, infrastructure and investment divisions. Taking into account the penalty, Keppel's PATMI plunged 72% y-o-y to S$217m.

Declared 14 Scts final dividend, bringing FY17 total dividend to 22 Scts. As promised, Keppel ring-fenced the one-off financial penalty when considering the dividend payout, which is in line with their guidance of 40-50%.

O&M in the red but outlook improving. 4Q17 reported net loss of S$218m excluding the one-off penalty, largely due to additional S$81m provisions for losses made on the Sete Brasil projects and S$54m in impairment on other assets. In addition, there was a forex loss of S$50m during the quarter. These were partially offset by S$178m revaluation gain on investment properties.

Do not foresee major operational impact from bribery incident. Keppel has reassured investors that the global resolution brings an end to their bribery case in Brazil, and Keppel has put place enhanced compliance framework to prevent the recurrence of such incidents. Keppel has been actively engaging with customers on the situation and is confident that this would not affect their relationships with customers and future project tendering.

Net orderbook stood at S$3.9bn (excluding S$4bn for Sete projects), unchanged from last quarter. New orders in 2017 amounted to S$1.2bn, more than doubled of 2016's S$500m. The projects won include LNG fuel containerships, FPSO jobs, and dredgers. We expect ordering activities for production/LNG facilities to pick up this year, potentially driving the increase in order wins to S$3bn.

Golar extending notice to proceed in mid- and end-2018. The notice to proceed for second (Gandria) and third (Gimi) unit of FLNG conversions for Golar have been extended. The Final Investment Decision (FID) for Gandria is expected in 2018 and Golar has provided funds to kick start some early work in the conversion of Gandria.

Time is not ripe for acquisitions. In response to questions on a merger, management has reiterated their stance that Keppel is comfortable with its current O&M capacity after a massive right-sizing exercise. It does not make sense to acquire more capacity at this juncture.

Property marked recorded another stellar year; low landbank cost. Property Division posted a net profit of S$685m in 2017, up 10% y-o-y. Home sales totaled 5,480 units, of which 3,725 homes were sold in China, 1,110 in Vietnam, 380 in Singapore, and 270 in Indonesia. Overall sale volume was marginally lower than 2016 by 4%, due to tightening measures in China and timing of launches in Vietnam. Of the 63,000 homes in the pipeline, about 16,7800 homes are ready for launch from now till 2020, representing 3.1x of 2017 home sales.

ROE target remains. Keppel Land achieved an average ROE of 9.4% over the past five years and management remains committed to achieve through cycle ROE of 12%.

Creaming on low cost landbank. 70% of Keppel Land's residential land bank was acquired more than seven years ago at relatively lower cost, realising RNAV when development is completed.

Infrastructure delivered 33% growth to S$132m profit in FY17. The strong performance was driven by energy infrastructure business as well as growing operations and maintenance of the assets. We expect steady performance from infrastructure going forward.

Investment recorded a strong net profit of S$235m, underscoring stronger contributions from Keppel Capital and Investment in Tianjin Eco-city, which contributed S$120m in FY17 (vs S$34m in 2016).

Tianjin Eco-City land sales expected. While sales might be lumpy from quarter to quarter, management expects Tianjin Eco-City land sale to contribute steadily on a yearly basis.

Quarterly / Interim Income Statement (S$m)

FY Dec	4Q2016	3Q2017	4Q2017	% chg yoy	% chg qoq
Revenue	1,940	1,617	1,545	(20.4)	(4.5)
Cost of Goods Sold	(1,214)	(1,035)	(1,099)	(9.5)	6.2
Gross Profit	**726**	**582**	**446**	**(38.6)**	**(23.4)**
Other Oper. (Exp)/Inc	(628)	(258)	(320)	(49.0)	24.0
Operating Profit	**98.0**	**324**	**126**	**28.2**	**(61.2)**
Other Non Opg (Exp)/Inc	4.90	11.2	4.15	(15.3)	(63.0)
Associates & JV Inc	143	45.4	77.7	(45.9)	71.1
Net Interest (Exp)/Inc	(40.5)	(17.5)	(0.7)	98.3	96.0
Exceptional Gain/(Loss)	0.0	0.0	(619)	nm	nm
Pre-tax Profit	**206**	**363**	**(412)**	**nm**	**nm**
Tax	(54.7)	(71.7)	(87.6)	60.1	22.2
Minority Interest	(8.2)	0.28	3.66	nm	nm
Net Profit	**143**	**292**	**(496)**	**nm**	**nm**
Net profit bef Except.	143	292	123	(14.1)	(57.9)
EBITDA	316	431	256	(18.8)	(40.5)
Margins (%)					
Gross Margins	37.4	36.0	28.9		
Opg Profit Margins	5.1	20.0	8.1		
Net Profit Margins	7.4	18.0	(32.1)		

Source of all data: Company, DBS Bank

CRITICAL DATA POINTS TO WATCH

Critical Factors

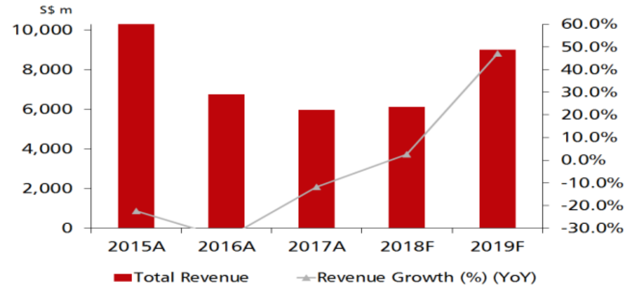
Orderbook the key driver of Keppel O&M's earnings; FLNG and production facilities to fill the gap. Keppel O&M is on the cusp of recovery, seeing stronger order flows as it clinched S$1.2bn in new orders in FY17, from S$500m in FY16. We expect the momentum to accelerate in 2018, with higher order win expectation of S$3bn. 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$4-5bn 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. 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.

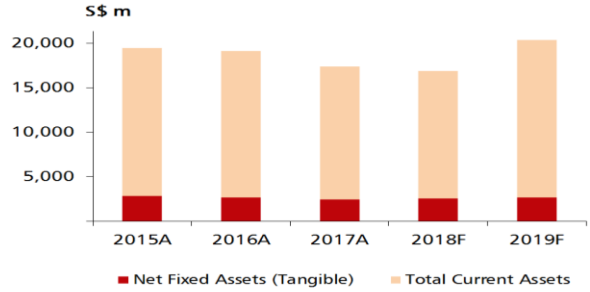
Infrastructure division's earnings buoyed by handover of problematic assets. The bad apple situation with Keppel Infrastructure's EPC projects has improved with the handover of the two Greater Manchester EfW (energy-from-waste) plants and Doha North in 2015. Thus, lower EPC provisions going forward should 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. Our telecom analyst has a FULLY VALUED call on M1 as its fundamentals are uninspiring. Upside risk comes from the potential sale of M1's stake by major shareholders (with a combined stake of 61%). 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.

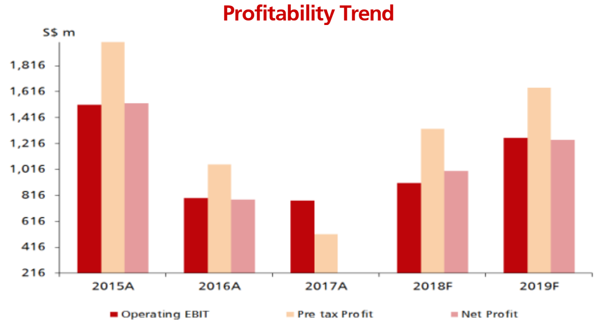
Sales Trend



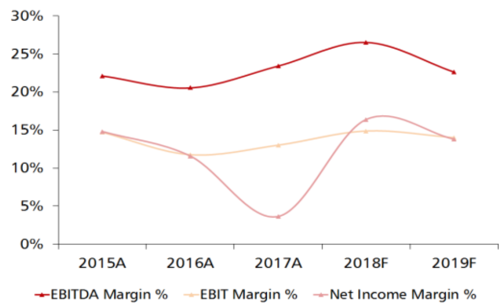
Asset Trend



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 0.46x as of end-4Q17, aided by capital recycling. Assuming the payment of financial penalty were to take place in 2017, net gearing would have been 0.51x.

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:

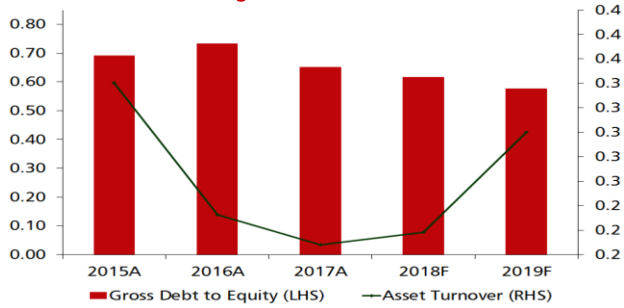
Competition from foreign yards. Keener competition from Chinese yards – which are usually aggressive in their pricing and lax with payment terms – as well as Korean peers may affect order wins and profitability, especially if Keppel starts to offer concessions to protect market share.

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.

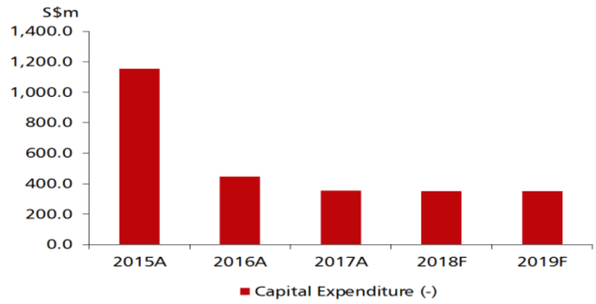
Company Background

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.

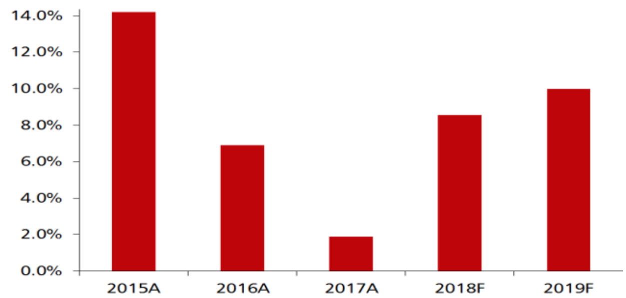
Leverage & Asset Turnover (x)



Capital Expenditure



ROE (%)



Forward PE Band (x)

PB Band (x)

Source: Company, DBS Bank

Key Assumptions

FY Dec	2015A	2016A	2017A	2018F	2019F
O&M order wins (S$ m)	1,773	500	1,500	3,000	0.0
	0.03	0.03	0.03	0.03	0.03
	0.03	0.03	0.03	0.03	0.03

Segmental Breakdown

FY Dec	2015A	2016A	2017A	2018F	2019F
Revenues (S$m)					
Offshore and Marine	6,241	2,854	1,801	2,067	4,078
Property	1,926	2,035	1,782	1,814	2,591
Infrastructure	2,058	1,744	2,207	2,059	2,144
Investments	71.1	134	173	181	190
Total	10,296	6,767	5,964	6,121	9,003
EBIT (S$m)					
Offshore and Marine	597	135	(176)	244	409
Property	636	505	656	472	648
Infrastructure	221	93.8	122	113	118
Investments	45.6	48.4	173	81.2	85.3
Others	14.1	13.3	0.10	0.0	0.0
Total	1,514	795	776	910	1,260
EBIT Margins (%)					
Offshore and Marine	9.6	4.7	(9.8)	11.8	10.0
Property	33.0	24.8	36.8	26.0	25.0
Infrastructure	10.7	5.4	5.5	5.5	5.5
Investments	64.2	36.1	100.3	45.0	45.0
Others	N/A	N/A	N/A	N/A	N/A
Total	14.7	11.8	13.0	14.9	14.0

Income Statement (S$m)

FY Dec	2015A	2016A	2017A	2018F	2019F
Revenue	10,296	6,767	5,964	6,121	9,003
Cost of Goods Sold	(7,023)	(4,204)	(3,999)	(3,894)	(6,068)
Gross Profit	3,273	2,563	1,965	2,226	2,935
Other Opng (Exp)/Inc	(1,760)	(1,768)	(1,189)	(1,316)	(1,675)
Operating Profit	1,514	795	776	910	1,260
Other Non Opg (Exp)/Inc	15.0	15.2	19.9	12.2	18.0
Associates & JV Inc	504	345	390	488	528
Net Interest (Exp)/Inc	(35.5)	(100)	(51.3)	(81.8)	(159)
Exceptional Gain/(Loss)	0.0	0.0	(619)	0.0	0.0
Pre-tax Profit	1,997	1,055	516	1,329	1,647
Tax	(404)	(233)	(298)	(279)	(346)
Minority Interest	(68.3)	(37.9)	(0.5)	(47.2)	(58.5)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	1,525	784	217	1,002	1,242
Net Profit before Except.	1,476	784	835	1,002	1,242
EBITDA	2,280	1,392	1,398	1,625	2,040
Growth					
Revenue Gth (%)	(22.5)	(34.3)	(11.9)	2.6	47.1
EBITDA Gth (%)	(27.7)	(39.0)	0.4	16.2	25.5
Opg Profit Gth (%)	(36.2)	(47.5)	(2.5)	17.4	38.4
Net Profit Gth (Pre-ex) (%)	2.2	(46.9)	6.6	20.0	23.9
Margins & Ratio					
Gross Margins (%)	31.8	37.9	32.9	36.4	32.6
Opg Profit Margin (%)	14.7	11.8	13.0	14.9	14.0
Net Profit Margin (%)	14.8	11.6	3.6	16.4	13.8
ROAE (%)	14.2	6.9	1.9	8.5	10.0
ROA (%)	5.0	2.7	0.8	3.6	4.1
ROCE (%)	5.6	2.9	1.5	3.5	4.6
Div Payout Ratio (%)	40.4	46.3	184.6	40.0	40.0
Net Interest Cover (x)	42.6	7.9	15.1	11.1	7.9

Source: Company, DBS Bank

Quarterly / Interim Income Statement (S$m)

FY Dec	4Q2016	1Q2017	2Q2017	3Q2017	4Q2017
Revenue	1,940	1,248	1,554	1,617	1,545
Cost of Goods Sold	(1,214)	(824)	(1,042)	(1,035)	(1,099)
Gross Profit	**726**	**425**	**512**	**582**	**446**
Other Oper. (Exp)/Inc	(628)	(237)	(374)	(258)	(320)
Operating Profit	**98.0**	**187**	**139**	**324**	**126**
Other Non Opg (Exp)/Inc	4.90	2.77	1.72	11.2	4.15
Associates & JV Inc	143	170	96.6	45.4	77.7
Net Interest (Exp)/Inc	(40.5)	(13.5)	(19.6)	(17.5)	(0.7)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	(619)
Pre-tax Profit	**206**	**347**	**217**	**363**	**(412)**
Tax	(54.7)	(76.4)	(62.7)	(71.7)	(87.6)
Minority Interest	(8.2)	(10.0)	5.59	0.28	3.66
Net Profit	**143**	**260**	**160**	**292**	**(496)**
Net profit bef Except.	143	112	173	292	123
EBITDA	316	416	294	431	256
Growth					
Revenue Gth (%)	33.0	(35.7)	24.5	4.0	(4.5)
EBITDA Gth (%)	(13.0)	31.8	(29.3)	46.6	(40.5)
Opg Profit Gth (%)	(47.2)	91.1	(26.0)	133.8	(61.2)
Net Profit Gth (Pre-ex) (%)	(36.3)	(21.5)	54.2	68.6	(57.9)
Margins					
Gross Margins (%)	37.4	34.0	33.0	36.0	28.9
Opg Profit Margins (%)	5.1	15.0	8.9	20.0	8.1
Net Profit Margins (%)	7.4	20.9	10.3	18.0	(32.1)

Balance Sheet (S$m)

FY Dec	2015A	2016A	2017A	2018F	2019F
Net Fixed Assets	2,846	2,645	2,433	2,569	2,685
Invts in Associates & JVs	5,410	5,315	5,901	6,339	6,816
Other LT Assets	4,081	4,807	4,826	4,826	4,826
Cash & ST Invts	2,118	2,361	2,477	1,840	2,429
Inventory	10,763	10,026	8,782	8,744	10,003
Debtors	3,141	3,450	3,169	3,188	4,689
Other Current Assets	563	630	524	524	524
Total Assets	**28,921**	**29,234**	**28,113**	**28,030**	**31,972**
ST Debt	857	1,835	1,714	1,714	1,714
Creditor	4,972	4,753	5,372	4,708	6,925
Other Current Liab	2,954	2,582	2,366	2,297	3,122
LT Debt	7,402	7,218	6,079	6,079	6,079
Other LT Liabilities	811	512	621	621	621
Shareholder's Equity	11,096	11,659	11,433	12,035	12,877
Minority Interests	830	675	528	575	634
Total Cap. & Liab.	**28,921**	**29,234**	**28,113**	**28,030**	**31,972**
Non-Cash Wkg. Capital	6,541	6,770	4,738	5,451	5,169
Net Cash/(Debt)	(6,141)	(6,692)	(5,316)	(5,953)	(5,364)
Debtors Turn (avg days)	100.2	177.7	202.6	189.6	159.7
Creditors Turn (avg days)	284.2	447.3	488.0	499.9	363.9
Inventory Turn (avg days)	577.5	956.2	906.5	869.1	586.4
Asset Turnover (x)	0.3	0.2	0.2	0.2	0.3
Current Ratio (x)	1.9	1.8	1.6	1.6	1.5
Quick Ratio (x)	0.6	0.6	0.6	0.6	0.6
Net Debt/Equity (X)	0.5	0.5	0.4	0.5	0.4
Net Debt/Equity ex MI (X)	0.6	0.6	0.5	0.5	0.4
Capex to Debt (%)	14.0	4.9	4.6	4.5	4.5
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	2017A	2018F	2019F
Pre-Tax Profit	1,997	1,055	516	1,329	1,647
Dep. & Amort.	247	236	212	214	234
Tax Paid	(302)	(223)	(322)	(194)	(279)
Assoc. & JV Inc/(loss)	(504)	(345)	(390)	(488)	(528)
Chg in Wkg.Cap.	(1,801)	(643)	1,290	(798)	215
Other Operating CF	(422)	250	71.1	0.0	0.0
Net Operating CF	**(786)**	**330**	**1,378**	**63.1**	**1,289**
Capital Exp.(net)	(1,153)	(447)	(356)	(350)	(350)
Other Invts.(net)	0.0	0.0	0.0	0.0	0.0
Invts in Assoc. & JV	(330)	(151)	(194)	(150)	(149)
Div from Assoc & JV	351	404	270	200	200
Other Investing CF	1,339	(115)	662	0.0	0.0
Net Investing CF	**207**	**(310)**	**382**	**(300)**	**(299)**
Div Paid	(956)	(622)	(390)	(400)	(401)
Chg in Gross Debt	924	817	(1,007)	0.0	0.0
Capital Issues	8.89	1.13	4.29	0.0	0.0
Other Financing CF	(3,269)	(29.5)	(122)	0.0	0.0
Net Financing CF	**(3,292)**	**167**	**(1,515)**	**(400)**	**(401)**
Currency Adjustments	28.1	7.10	(58.2)	0.0	0.0
Chg in Cash	(3,843)	194	187	(637)	589
Opg CFPS (S cts)	55.9	53.5	4.80	47.3	59.1
Free CFPS (S cts)	(107)	(6.4)	56.2	(15.8)	51.7

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
16:	22 Jan 18	8.29	10.30	BUY

Source: DBS Bank
Analyst: Pei Hwa HO

DBS Bank recommendations are based an Absolute Total Return* Rating system, defined as follows:
STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)
BUY (>15% total return over the next 12 months for small caps, >10% for large caps)
HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)
FULLY VALUED (negative total return i.e. > -10% over the next 12 months)
SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

Completed Date: 26 Jan 2018 09:08:59 (SGT)
Dissemination Date: 26 Jan 2018 11:13:40 (SGT)

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4. Danny Teoh Leong Kay, a member of DBS Group Holdings Board of Directors, is a Director of Keppel Corporation as of 31 Dec 2017

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Sembcorp Industries

Version 16 | Bloomberg: SCI SP | Reuters: SCIL.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

26 Feb 2018

BUY

Last Traded Price (23 Feb 2018): S$3.24 (**STI :** 3,533.22)
Price Target 12-mth: S$4.40 (36% upside) (Prev S$4.50)

Analyst
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What's New

- Utilities earnings dragged by provisions in 4Q17
- Repositioning as a Global Integrated Energy Player
- Unlocking value through IPO and divestments
- Reiterate BUY; TP adjusted to S$4.40

Price Relative

Forecasts and Valuation

FY Dec (S$ m)	2016A	2017A	2018F	2019F
Revenue	7,907	8,346	8,290	8,566
EBITDA	1,355	1,423	1,422	1,510
Pre-tax Profit	537	312	486	557
Net Profit	395	231	365	411
Net Pft (Pre Ex.)	407	352	365	411
Net Pft Gth (Pre-ex) (%)	230.1	(13.6)	3.8	12.5
EPS (S cts)	22.1	12.9	20.4	23.0
EPS Pre Ex. (S cts)	22.8	19.7	20.4	23.0
EPS Gth Pre Ex (%)	230	(14)	4	12
Diluted EPS (S cts)	21.9	12.8	20.3	22.8
Net DPS (S cts)	7.99	5.00	6.53	7.35
BV Per Share (S cts)	375	390	405	422
PE (X)	14.7	25.1	15.9	14.1
PE Pre Ex. (X)	14.2	16.5	15.9	14.1
P/Cash Flow (X)	6.6	8.9	3.7	3.9
EV/EBITDA (X)	10.8	10.0	9.6	8.8
Net Div Yield (%)	2.5	1.5	2.0	2.3
P/Book Value (X)	0.9	0.8	0.8	0.8
Net Debt/Equity (X)	0.9	0.9	0.8	0.7
ROAE (%)	6.0	3.4	5.1	5.6
Earnings Rev (%):		(18)	(11)	(13)
Consensus EPS (S 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

Unlocking value through IPO, divestment

Maintain BUY; TP lowered to S$4.40, after lowering our target price for Sembcorp Marine (SMM) from S$3.10 to S$2.90. While the market may be disappointed as there were no drastic actions announced, such as SMM divestment in the Strategic Review, key strategies to grow utilities business and more active capital recycling should be positive for Sembcorp Industries (SCI) in enhancing its ROE. We continue to like 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.

Repositioning; Recycling Capital. SCI is repositioning its Utilities business to be a global integrated energy player, rebalancing its portfolio in terms of markets and products, with targets to double the renewables portfolio. Its focus on more proactive capital recycling will allow SCI to augment its balance sheet (lower gearing by 0.15x), and enhance ROE. Including IPO of the India assets, we estimate that proceeds will easily exceed S$1bn over the next 2-years, much higher than ~S$870m of IPO/divestment proceeds achieved over the last 5 years.

Where we differ: 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. While the marine spin-off did not happen in the recent strategy review, we hold on to our belief of a potential merger between Keppel's O&M arm and SMM in view of keener competition in the sector. The potential spin-off of its marine arm could re-rate SCI's undervalued utilities business that is overshadowed by the cyclical marine business.

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) to derive a TP of S$4.40, 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 (Sm/USm)	5,782 / 4,383
Major Shareholders (%)	
Temasek Holdings Pte Ltd	49.5
Mondrian Investment Partners Ltd	4.9
Free Float (%)	45.6
3m Avg. Daily Val (US$m)	10.4

ICB Industry : Oil & Gas / Oil Equipment, Services & Dist

WHAT'S NEW

A kitchen sinking year; unveiling Strategic Review

Results highlights

A kitchen sinking year. Net profit in 2017 declined 44% y-o-y to S$230.8m, hit by weak Marine segment that was barely profitable, losses in SGPL, refinancing charges, and impairments and write-offs.

Utilities dragged by provisions in 4Q17. Group headline net profit came in below expectations, declining 32% q-o-q to S$22.8m in 4Q17. Besides Marine's weakness (61%-owned SMM reported net loss of S$34m in 4Q17), utilities segment was dragged by S$25.4m provision for potential fines and claims arising from alleged environment offences in an overseas water plant. Otherwise, core utilities profit of c.S$70m was largely in line.

India operations affected by scheduled maintenance shutdown and coal price. India utilities incurred larger than expected losses of ~S$36m (TPCIL: -S$4m; SGPL: -S$27m; SGI: -S$5m) in 4Q17 due to scheduled maintenance shutdown and higher coal cost. For TPCIL, the higher coal cost will be reflected in tariffs with a 6-month lag under the long-term PPA.

China operations were stronger than expected, rising 270% q-o-q, lifted by the contribution from maiden full quarter contribution of Changzhi plant and write back of bad debts. This mitigated the weaker India performance.

Marine net loss amounted to S$33.8m for 4Q17 (SCI's share of S$20m)**.** Stripping out forex gain (S$20m), tax credit (S$19m) and inventory & work-in-progress write back (S$32m), losses would have been c.S$100m, of which we believe a substantial portion was attributable to expected cost overrun for variation orders on several projects as customers have yet agreed to pay. We believe total cost overrun for disputed variation orders exceeded S$100m last year. We expect a gradual improvement ahead as some of the cost overruns for disputed variation orders in 2017 could be recouped this year and better economies of scale from higher activity level towards 2H18 should help.

SCI declared 2Scts final dividend, bringing full year dividend to 5Scts, representing 1.5% yield.

Quarterly / Interim Income Statement (S$m)

FY Dec	4Q2016	3Q2017	4Q2017	% chg yoy	% chg qoq
Revenue	2,026	1,808	2,123	4.8	17.5
Cost of Goods Sold	(1,776)	(1,576)	(1,919)	8.1	21.8
Gross Profit	**250**	**232**	**204**	**(18.4)**	**(12.0)**
Other Oper. (Exp)/Inc	(36.7)	(14.9)	(183)	398.1	1,125.8
Operating Profit	**214**	**217**	**21.4**	**(90.0)**	**(90.1)**
Other Non Opg (Exp)/Inc	0.0	0.0	29.7	nm	nm
Associates & JV Inc	47.9	26.9	44.9	(6.2)	67.3
Net Interest (Exp)/Inc	(127)	(117)	(70.5)	44.3	39.9
Exceptional Gain/(Loss)	30.4	(56.3)	(25.4)	nm	(54.9)
Pre-tax Profit	**165**	**70.3**	**0.12**	**(99.9)**	**(99.8)**
Tax	(12.2)	(28.1)	7.50	nm	nm
Minority Interest	(5.5)	(8.6)	15.2	nm	nm
Net Profit	**147**	**33.6**	**22.8**	**(84.6)**	**(32.2)**
Net profit bef Except.	117	89.9	48.2	(58.8)	(46.4)
EBITDA	262	244	96.1	(63.3)	(60.6)
Margins (%)					
Gross Margins	12.4	12.8	9.6		
Opg Profit Margins	10.5	12.0	1.0		
Net Profit Margins	7.3	1.9	1.1		

Source of all data: Company, DBS Bank

Strategic Review

Overall, key strategies to grow its utilities business and proactive capital recycling is positive for SCI in enhancing ROE. Although we were hopeful of more concrete plans in relation to Marine segment, be it a demonstration of synergies within the group or divestment through dividend in specie.

Please click for our previous expectation on SCI's review: Sembcorp Industries: Strategic Review Next Week?

Repositioning as a Global Integrated Energy Player; Proactive Capital Recycling: SCI unveiled the conclusion of its Strategic Review launched in May-2017. Key strategies include:

1. *"Repositions the Utilities business as an **integrated energy player** and targets to **double renewables portfolio**"*
2. *"**Unlocks value** with targeted utilities divestments of up to S$0.5 billion over the next two years and proposed IPO of India energy business"*

For Marine Business, SCI is confident that Sembcorp Marine (SMM), is well-positioned to benefit from the industry's recovery and **will continue to support the Marine business** through the cycle.

The Urban Development business **is steadily growing**. SCI will continue to leverage off its strong franchise in Asia, as a valued partner to governments in host countries.

Deepening presence in four key markets – Singapore & SEA, India, China and the UK

Source: Company

Repositioning as an Integrated Energy Player. The Utilities business will focus on growing three business lines - Gas & Power; Renewables & Environment; and Merchant & Retail, with the aim of having a balanced portfolio in developing and developed markets in four key markets, namely Singapore & Southeast Asia; China; India and the UK.

i) Gas & Power business will target opportunities in thermal power, gas importation and retail as well as regas infrastructure

ii) Renewables & Environment business will focus on renewables, water and wastewater treatment as well as waste-to-resource growth opportunities in the low-carbon and circular economies

iii) Merchant & Retail business, with its newly added merchant capabilities, will enable the business to capture opportunities closer to customers in multiple markets and enhance competitiveness and returns

What's new? The repositioning involves changes in key market focus, portfolio rebalancing between developing and developed markets and trend towards cleaner and sustainable assets such as renewable energy. In addition, upstream and midstream integration will be further enhanced through gas transportation and Merchant & Retail expansion. There will also be more deployment of digital technologies to enhance operations and capture new opportunities.

Utilities: Three business lines

Source: Company

Doubling renewable energy assets to ~4000MW by 2022. Besides China and India, in which SCI has strong market positioning, management sees opportunities in the UK/Europe, Australia/New Zealand, Singapore & SEA. SCI plans to expand more into wind power (in particular onshore wind) which has higher barriers to entry than solar. The split between wind and solar will likely be 75%:25%.

Our take: Renewable energy is a cleaner form of alternative energy source that complements conventional thermal power. The economics has improved vastly in recent years with the falling levelised cost of electricity. In emerging markets, the return could be double that of developed markets like Europe, compensating for higher regulatory and business risks especially on offtakers. The experience accumulated in China and India should help in managing the risks.

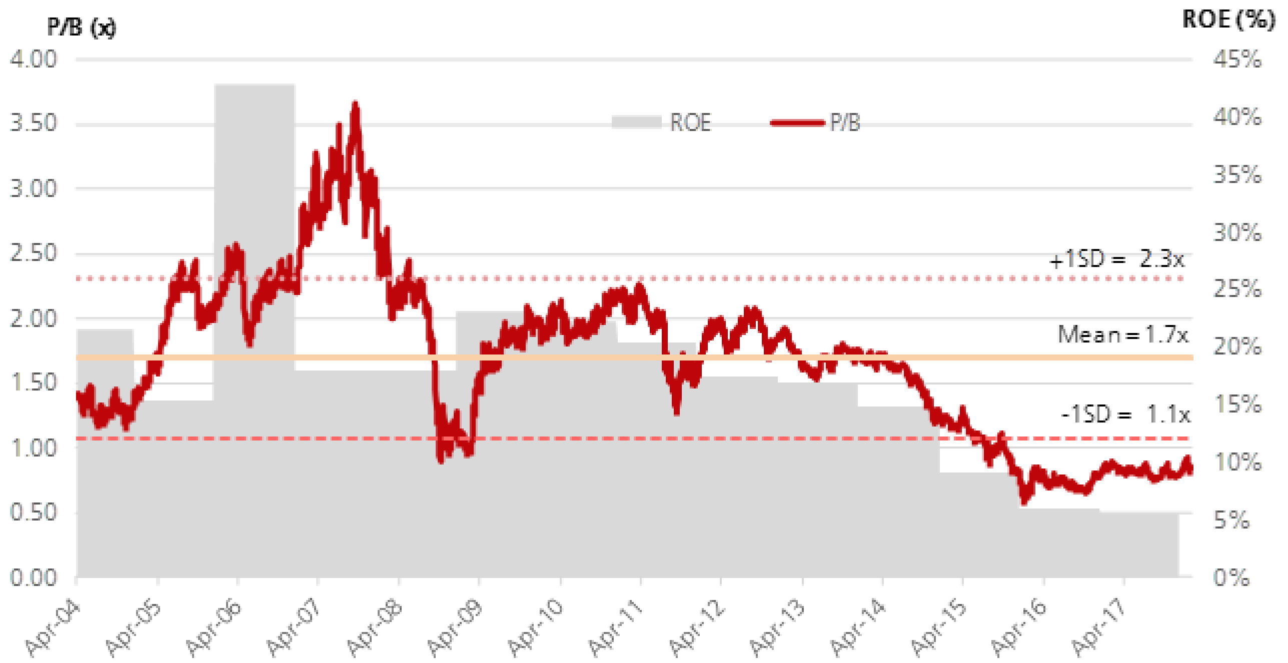
More active and systematic capital recycling to fund acquisitions. In addition to the proposed IPO of India assets, SCI targets utilities divestments of up to S$0.5 billion over the next two years. As a good start, the Group has entered into a conditional sale agreement to divest its 100% stake in Sembcorp Utilities South Africa for gross proceeds of ZAR 790m or S$89m.

Our take: Including the IPO of India assets, proceeds would easily exceed S$1bn over the next 2-years, much more than ~S$870m of IPO/divestment proceeds achieved over the last 5 years. Its focus on more proactive capital recycling will allow it to augment its balance sheet (lowering gearing by 0.15x), deliver sustainable growth, and enhance ROE.

Target for double digit ROE. Management guided that they aim to improve the ROE from current mid-single digit to double-digit over the next 5-years through improvements in both Marine and Utilities segments.

Our take: This can be achieved through divestment of non-core/non-performing assets, and earnings growth. Two key drivers are SMM and SGPL's turnaround. For SMM, we expect earnings to recover following an increase in its orderbook but ROE will likely to stay at the single digit level in the next two years. For SGPL, it appears that the improving power supply/demand dynamics in India will lead to government's commitments for long-term PPAs. ROE recovery is a critical factor for SCI's re-rating in our view.

SCI's ROE has been declining over the past 10 years, resulting in lower valuations



Source: Company

IPO of India Assets. SCI has reorganised and consolidated all its India Energy assets under Sembcorp Energy India Limited (SEIL, 93.7% stake), comprising TPCIL, SGPL and SGI. On 23 Feb, SCI initiated the process for an IPO of SEIL on BSE Limited and the National Stock Exchange of India.

Our take: Based on our back-on-the-envelope calculations, the IPO of SEIL could yield approx. ~S$200m revaluation gains in total, of which nearly half could be realised gains if SCI divests 43% of its interest and retains ~50% stake in SEIL. The divestment could free up ~S$600m cash for SCI. We are conservative in our calculations as the valuation for SEIL could be higher in the event (i) SGPL secures a long-term PPA earlier than expected; (ii) market recovery, and (iii) renewable segment sees stronger growth and returns ahead.

DBS' estimate on SEIL's valuation.

Name	Business	Net Profit (S$ m) 2017	Net Profit (S$ m) 2018F	ROE	Book Value 2017E	DBS' Valuation	Metrics	Implied Valuation PB	Implied Valuation PE
SGI	Renewable (Wind and Solar)	17	21	5%	404	485	1.2x PB	1.2	23
TPCIL	Coal-fired Power Plant I	34	55	11%	522	630	DCF (WACC 11.5%, terminal growth 0%)	1.2	13
SGPL	Coal-fired Power Plant II	-107	-72	nm	400	402	DCF (WACC 11.5%, terminal growth 0%)	1.0	nm
SEIL	Total	-56	4	nm	1,326	1,518	192	1.1	nm

Source: Company, Prospectus (SEIL), DBS Bank

Marine - some synergies possible. Management believes that SMM is well-positioned to benefit from industry recovery with its diversified, innovative solutions across the offshore and marine value chain, both within and beyond the oil and gas sector. SCI will thus continue to support the business through the cycle.

Our take: While marine spin-off did not happen in the recent strategy review, we hold on to our belief of a potential merger between Keppel's O&M arm and SMM in view of keener competition in the sector. Spinning-off its marine arm could re-rate SCI's undervalued utilities business that is currently overshadowed by the cyclical marine business. Meanwhile, SCI could demonstrate some form of synergies through placing orders with SMM for gas solutions such as FSRU, Gravifloat modularized LNG terminals, LNG vessels etc. In addition, SMM could also supply SCI with offshore windfarm facilities if attractive offshore windfarm opportunities arise.

Urban Development –industrialisation and urbanisation trends. SCI's urban development business is uniquely placed to capture opportunities from industrialisation and urbanisation in its core markets – China, Vietnam and Indonesia.

Our take: Urban Development is synergistic to SCI's utilities business, as post land / property development, SCI could continue to support the utilities of the new industrial / commercial / residential estates. SCI's land and property development expertise could also be helpful if SMM decides to redevelop the Admiralty Shipyard into a waterfront township.

Recommendation

Maintain BUY with a slightly lower TP of S$4.40, mainly to account for SMM's TP revision from S$3.10 to S$2.90. FY18/19F earnings are reduced by 10-13% largely due to the earnings revisions for SMM. For India thermal power plants, we have also reduced our earnings projections by S$18m in view of the higher coal cost, partially offset by higher renewable earnings of S$6m after the stake increase in Sept-17.

CRITICAL DATA POINTS TO WATCH

Critical Factors

Earnings recovery. We expect earnings recovery for both Utilities and Marine segments. For Utilities in India, 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; and losses at its second plant, Sembcorp Gayatri Power Ltd (SGPL), in the absence of long term PPA since coming online in Feb-2017, should reduce by S$20m after refinancing exercise last year. In China, the new Chongqing plant will probably contribute more meaningfully from 2018. For Marine, we expect turnaround driven by strong contract wins translating to higher yard activities.

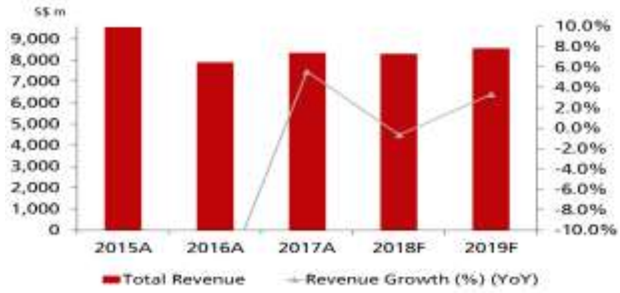
Utilities in emerging markets remain the growth engine. Besides India, SCI has also made forays into other emerging markets - Bangladesh and Myanmar - and this should underpin the longer-term growth prospects of its utilities segment beyond 2018. Long-term PPAs have been secured for both Myanmar's 230MW 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, to S$3bn in 2018, driven by the new Gravifloat modularized LNG terminal solutions and FPSO projects. SMM's orderbook stood at S$7.58bn as at Dec 2017, with c.S$3.2bn from the drillship projects with Sete Brasil and S$1.1bn for Borr Drilling. 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.

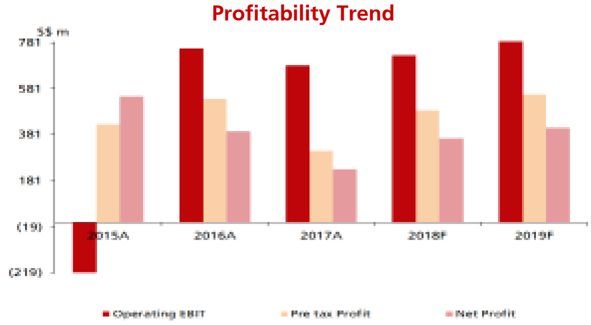
Potential "Big Three Rationalisation"? Since Aug-2015, we have flagged up the potential of a merger between Keppel's O&M arm and SMM in a structural downturn. There are various ways to embark on the rationalisation exercise of the big three homegrown industrial plays - SCI, SMM and Keppel Corp. We believe 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

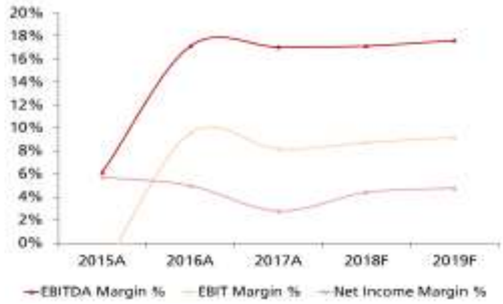


Asset Trend

Profitability Trend



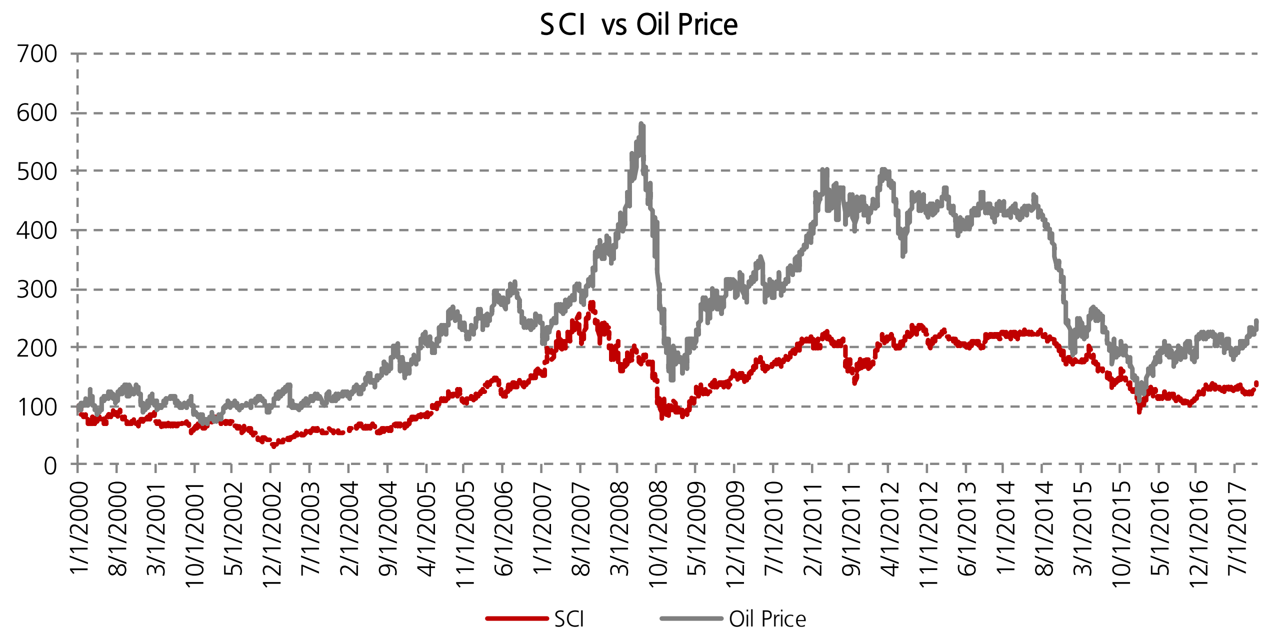
Margin Trends (%)



Source: Company, DBS Bank

Appendix 1:

Sembcorp Industries Share Price vs Oil Price (1 Jan 2000 = 100)



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

Sembcorp Industries P/B vs ROE; Turnaround of SGPL a key earnings and ROE driver

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

Balance Sheet:

SCI's net gearing declined marginally to 0.9x as at Dec-2017, from 1.0x a quarter ago as Marine's gearing dropped by 0.2x following deposit collection from Borr Drilling. Still, this is a stark contrast to a net cash position in 2013; increasing leverage at SMM and expansion into India have been the main reasons 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 further. 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:

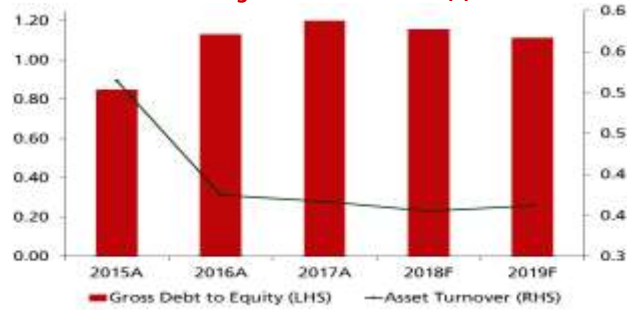
Increasing competition in the Singapore power market. Total power generation supply in Singapore rose by over 9% y-o-y in the past two years, marking the biggest y-o-y jumps since the electricity market started. This depressed prices and hurt SCI's bottom line. The oversupply of capacity and over-commitment 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.

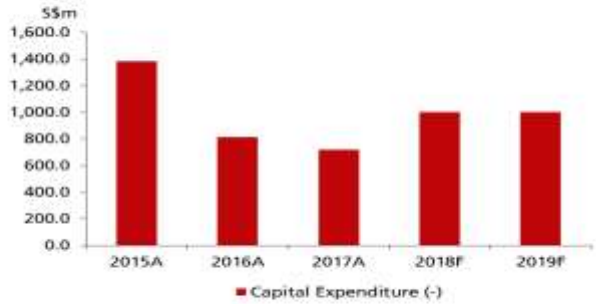
Company Background

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.

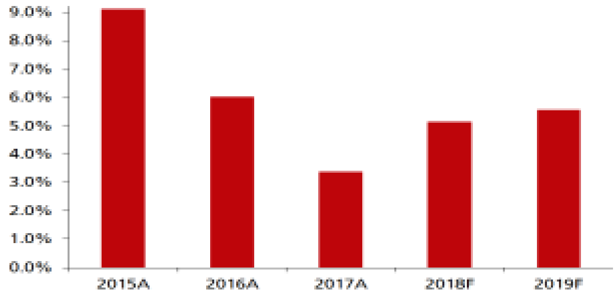
Leverage & Asset Turnover (x)



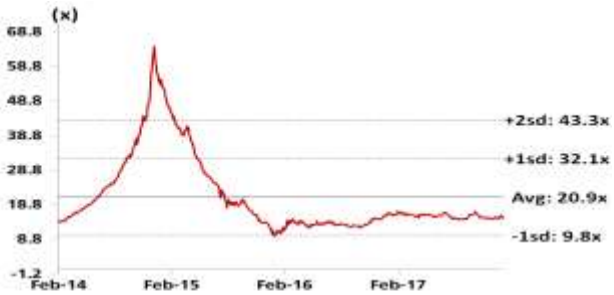
Capital Expenditure



ROE (%)



Forward PE Band (x)



PB Band (x)

Source: Company, DBS Bank

Key Assumptions

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

Segmental Breakdown

FY Dec	2015A	2016A	2017A	2018F	2019F
Revenues (S$m)					
Utilities	4,227	4,111	5,670	4,149	4,170
Marine	4,967	3,544	2,387	3,905	4,202
Industrial Parks	7.95	7.05	7.76	12.4	14.9
Other Businesses and	342	245	280	224	179
Total	9,545	7,907	8,346	8,290	8,566
Net Profit before EI					
Utilities	701	348	140	315	337
Marine	(176)	48.3	6.83	30.3	65.8
Industrial Parks	33.5	33.3	83.2	49.9	37.5
Other Businesses and	(9.7)	(34.7)	0.68	(30.0)	(30.0)
Total	549	395	231	365	411
Net Profit before EI					
Utilities	16.6	8.5	2.5	7.6	8.1
Marine	(3.6)	1.4	0.3	0.8	1.6
Industrial Parks	421.3	472.2	1,072.8	402.8	251.8
Other Businesses and	(2.8)	(14.2)	0.2	(13.4)	(16.7)
Total	5.8	5.0	2.8	4.4	4.8

Income Statement (S$m)

FY Dec	2015A	2016A	2017A	2018F	2019F
Revenue	9,545	7,907	8,346	8,290	8,566
Cost of Goods Sold	(8,813)	(6,802)	(7,343)	(7,243)	(7,441)
Gross Profit	732	1,105	1,002	1,047	1,125
Other Opng (Exp)/Inc	(950)	(349)	(319)	(322)	(339)
Operating Profit	(218)	756	683	724	786
Other Non Opg (Exp)/Inc	418	39.6	29.7	(7.8)	(7.8)
Associates & JV Inc	6.20	125	164	131	129
Net Interest (Exp)/Inc	(205)	(372)	(444)	(362)	(351)
Exceptional Gain/(Loss)	426	(12.1)	(121)	0.0	0.0
Pre-tax Profit	426	537	312	486	557
Tax	28.1	(100)	(67.4)	(90.3)	(115)
Minority Interest	94.5	(42.3)	(13.9)	(31.0)	(31.0)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	549	395	231	365	411
Net Profit before Except.	123	407	352	365	411
EBITDA	590	1,355	1,423	1,422	1,510
Growth					
Revenue Gth (%)	(12.4)	(17.2)	5.5	(0.7)	3.3
EBITDA Gth (%)	(63.4)	129.6	5.1	(0.1)	6.2
Opg Profit Gth (%)	(120.5)	(446.5)	(9.7)	6.0	8.5
Net Profit Gth (Pre-ex) (%)	(84.6)	230.1	(13.6)	3.8	12.5
Margins & Ratio					
Gross Margins (%)	7.7	14.0	12.0	12.6	13.1
Opg Profit Margin (%)	(2.3)	9.6	8.2	8.7	9.2
Net Profit Margin (%)	5.8	5.0	2.8	4.4	4.8
ROAE (%)	9.1	6.0	3.4	5.1	5.6
ROA (%)	3.0	1.9	1.0	1.6	1.7
ROCE (%)	(1.5)	3.6	2.9	3.1	3.2
Div Payout Ratio (%)	35.8	36.2	38.7	32.0	32.0
Net Interest Cover (x)	(1.1)	2.0	1.5	2.0	2.2

Source: Company, DBS Bank

Quarterly / Interim Income Statement (S$m)

FY Dec	4Q2016	1Q2017	2Q2017	3Q2017	4Q2017
Revenue	2,026	2,140	2,275	1,808	2,123
Cost of Goods Sold	(1,776)	(1,899)	(1,950)	(1,576)	(1,919)
Gross Profit	**250**	**240**	**326**	**232**	**204**
Other Oper. (Exp)/Inc	(36.7)	(17.7)	(104)	(14.9)	(183)
Operating Profit	**214**	**223**	**222**	**217**	**21.4**
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	29.7
Associates & JV Inc	47.9	57.6	34.7	26.9	44.9
Net Interest (Exp)/Inc	(127)	(125)	(131)	(117)	(70.5)
Exceptional Gain/(Loss)	30.4	(5.2)	(33.9)	(56.3)	(25.4)
Pre-tax Profit	**165**	**150**	**91.4**	**70.3**	**0.12**
Tax	(12.2)	(14.9)	(31.9)	(28.1)	7.50
Minority Interest	(5.5)	(16.2)	(4.3)	(8.6)	15.2
Net Profit	**147**	**119**	**55.3**	**33.6**	**22.8**
Net profit bef Except.	117	124	89.2	89.9	48.2
EBITDA	262	280	257	244	96.1
Growth					
Revenue Gth (%)	(5.3)	5.6	6.3	(20.6)	17.5
EBITDA Gth (%)	20.1	7.2	(8.5)	(4.9)	(60.6)
Opg Profit Gth (%)	(0.4)	4.3	(0.4)	(2.1)	(90.1)
Net Profit Gth (Pre-ex) (%)	16.9	6.2	(28.3)	0.8	(46.4)
Margins					
Gross Margins (%)	12.4	11.2	14.3	12.8	9.6
Opg Profit Margins (%)	10.5	10.4	9.8	12.0	1.0
Net Profit Margins (%)	7.3	5.6	2.4	1.9	1.1

Balance Sheet (S$m)

FY Dec	2015A	2016A	2017A	2018F	2019F
Net Fixed Assets	8,685	11,226	11,158	11,584	11,982
Invts in Associates & JVs	2,349	1,746	1,765	1,827	1,885
Other LT Assets	1,273	1,694	2,194	2,194	2,194
Cash & ST Invts	1,609	1,887	2,692	3,241	3,683
Inventory	4,233	3,466	3,214	2,763	2,447
Debtors	1,568	1,958	2,032	1,658	1,557
Other Current Assets	201	317	163	163	163
Total Assets	**19,915**	**22,290**	**23,213**	**23,424**	**23,906**
ST Debt	1,801	2,126	1,572	1,572	1,572
Creditor	3,388	3,398	3,819	3,793	3,920
Other Current Liab	758	492	445	375	406
LT Debt	5,032	7,096	8,275	8,275	8,275
Other LT Liabilities	894	1,016	886	886	886
Shareholder's Equity	6,433	6,701	6,969	7,245	7,539
Minority Interests	1,610	1,461	1,246	1,277	1,309
Total Cap. & Liab.	**19,915**	**22,290**	**23,213**	**23,424**	**23,906**
Non-Cash Wkg. Capital	1,856	1,852	1,145	416	(157)
Net Cash/(Debt)	(5,223)	(7,335)	(7,156)	(6,607)	(6,164)
Debtors Turn (avg days)	52.9	81.4	87.2	81.2	68.5
Creditors Turn (avg days)	132.8	194.5	193.8	208.3	205.8
Inventory Turn (avg days)	161.0	220.6	179.4	163.6	139.1
Asset Turnover (x)	0.5	0.4	0.4	0.4	0.4
Current Ratio (x)	1.3	1.3	1.4	1.4	1.3
Quick Ratio (x)	0.5	0.6	0.8	0.9	0.9
Net Debt/Equity (X)	0.6	0.9	0.9	0.8	0.7
Net Debt/Equity ex MI (X)	0.8	1.1	1.0	0.9	0.8
Capex to Debt (%)	20.2	8.8	7.3	10.2	10.2
Z-Score (X)	1.2	1.1	1.1	1.1	0.9

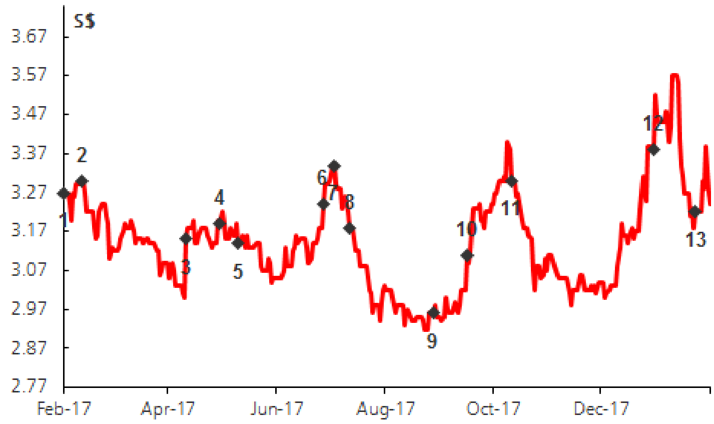
Source: Company, DBS Bank

Cash Flow Statement (S$m)

FY Dec	2015A	2016A	2017A	2018F	2019F
Pre-Tax Profit	426	537	312	486	556
Dep. & Amort.	405	454	571	575	604
Tax Paid	(150)	(85.8)	(69.9)	(159)	(90.3)
Assoc. & JV Inc/(loss)	(6.2)	(125)	(164)	(131)	(129)
Chg in Wkg.Cap.	(1,961)	(395)	(507)	798	549
Other Operating CF	525	487	507	0.0	0.0
Net Operating CF	(761)	872	650	1,568	1,490
Capital Exp.(net)	(1,381)	(810)	(718)	(1,000)	(1,000)
Other Invts.(net)	9.98	0.0	206	0.0	0.0
Invts in Assoc. & JV	(427)	(60.9)	37.8	0.0	0.0
Div from Assoc & JV	129	122	307	70.0	70.0
Other Investing CF	471	(51.6)	75.6	0.0	0.0
Net Investing CF	(1,199)	(801)	(92.3)	(930)	(930)
Div Paid	(415)	(225)	(162)	(89.4)	(117)
Chg in Gross Debt	2,046	1,107	779	0.0	0.0
Capital Issues	0.0	0.0	0.0	0.0	0.0
Other Financing CF	261	(668)	(363)	0.0	0.0
Net Financing CF	1,892	214	254	(89.4)	(117)
Currency Adjustments	14.7	(35.0)	(7.6)	0.0	0.0
Chg in Cash	(53.0)	250	804	549	443
Opg CFPS (S cts)	67.3	70.9	64.7	43.1	52.7
Free CFPS (S cts)	(120)	3.46	(3.8)	31.8	27.4

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	24 Feb 17	3.27	3.80	BUY
2:	06 Mar 17	3.30	3.80	BUY
3:	04 May 17	3.15	3.80	BUY
4:	23 May 17	3.19	3.80	BUY
5:	02 Jun 17	3.14	3.80	BUY
6:	20 Jul 17	3.24	4.10	BUY
7:	26 Jul 17	3.34	4.10	BUY
8:	04 Aug 17	3.18	4.00	BUY
9:	20 Sep 17	2.96	4.00	BUY
10:	09 Oct 17	3.11	4.00	BUY
11:	03 Nov 17	3.30	4.20	BUY
12:	22 Jan 18	3.38	4.50	BUY
13:	15 Feb 18	3.22	4.50	BUY

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

Source: DBS Bank
Analyst: Pei Hwa HO

DBS Bank recommendations are based an Absolute Total Return* Rating system, defined as follows:
STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)
BUY (>15% total return over the next 12 months for small caps, >10% for large caps)
HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)
FULLY VALUED (negative total return i.e. > -10% over the next 12 months)
SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

Completed Date: 26 Feb 2018 09:05:19 (SGT)
Dissemination Date: 26 Feb 2018 09:37:28 (SGT)

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

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Singapore Company Guide
Sembcorp Marine

Version 16 | Bloomberg: SMM SP | Reuters: SCMN.SI **Refer to important disclosures at the end of this report**

DBS Group Research . Equity 22 Feb 2018

BUY

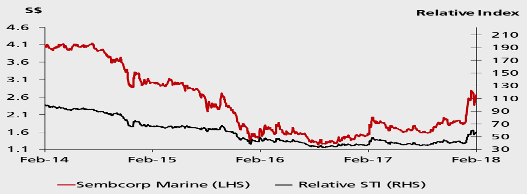
Last Traded Price (21 Feb 2018): S$2.63 **(STI :** 3,516.23)
Price Target 12-mth: S$2.90 (10% upside) (Prev S$3.10)

Analyst
Pei Hwa HO +65 6682 3714 peihwa@dbs.com

What's New

- Wider-than-expected loss in 4Q17 partly due to cost overrun for several projects' variation orders
- Slashed FY18/19 forecasts by 54-58% to reflect operating loss at current activity level; earnings improvement slipping into 2H18
- Declared 1 Sct final dividend
- Potential price pullback offers healthier entry point; TP adjusted to S$2.90

Price Relative



Forecasts and Valuation

FY Dec (S$ m)	2016A	2017A	2018F	2019F
Revenue	3,545	2,387	3,905	4,202
EBITDA	330	214	359	458
Pre-tax Profit	90.5	(15.6)	63.4	138
Net Profit	78.8	14.1	49.9	109
Net Pft (Pre Ex.)	78.8	(32.7)	49.9	109
Net Pft Gth (Pre-ex) (%)	nm	nm	nm	117.5
EPS (S cts)	3.77	0.67	2.39	5.20
EPS Pre Ex. (S cts)	3.77	(1.6)	2.39	5.20
EPS Gth Pre Ex (%)	(127)	(142)	(253)	117
Diluted EPS (S cts)	3.77	0.67	2.39	5.20
Net DPS (S cts)	2.50	2.00	2.00	2.00
BV Per Share (S cts)	123	119	119	122
PE (X)	69.8	390.1	110.0	50.6
PE Pre Ex. (X)	69.8	nm	110.0	50.6
P/Cash Flow (X)	9.7	110.6	10.3	11.7
EV/EBITDA (X)	25.5	38.7	22.4	17.4
Net Div Yield (%)	1.0	0.8	0.8	0.8
P/Book Value (X)	2.1	2.2	2.2	2.2
Net Debt/Equity (X)	1.1	1.1	1.0	0.9
ROAE (%)	3.1	0.6	2.0	4.3
Earnings Rev (%):			(58)	(54)
Consensus EPS (S cts):			4.2	6.1
Other Broker Recs:		B: 7	S: 6	H: 7

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

Look beyond weak near-term earnings

Maintain BUY; TP reduced to S$ 2.90 after earnings revisions, still based on higher 2.4x FY18 P/BV multiple (0.5SD below mean). We continue to like SMM as a key proxy to the recovery in the O&G and O&M sectors, with strong order wins as key re-rating catalyst. Though, in the near term, we reckon that sentiment might be adversely affected by the wider-than-expected losses in 4Q17; and the M&A premium, which we estimated to be ~40 Sct. This could be given back if privatisation rumour is off the table..

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 into S$3bn in new orders in 2018, which could potentially include 1) a semi-submersible production unit for Shell's Vito at S$400-800m; 2) Newbuild FPSO for Energean's Karish-Tanin project at S$500m; 3) two large Compressed Gas Liquid carriers for SeaOne Caribbean valued at S$800m in total; 4) a Gravifloat (SMM's proprietary technology) modularised LNG exporting terminal for Poly-GCL at c.S$1bn.

Reactivation of Sete Brasil rig orders. The landmark deal to sell all nine terminated jackup rigs to Borr Drilling and the disposal of harsh environment semisubmersible rig West Rigel have 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 4-5 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$ 2.90 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 corruption allegations in Brazil that, if found guilty, could lead to financial and reputational 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 (Sm/USm)	5,491 / 4,148
Major Shareholders (%)	
Sembcorp Industries Ltd	61.0
Franklin Resources	5.0
Free Float (%)	34.0
3m Avg. Daily Val (US$m)	18.1
ICB Industry : Oil & Gas / Oil Equipment, Services & Dist	

DBS
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WHAT'S NEW

4Q17 losses bigger than expected

First operating loss. With the exception of 4Q15, when earnings were hit by one-off massive provision, SMM has reported its first operating loss since 2004.

Net loss amounted to S$33.8m for 4Q17. Stripping out forex gains (S$20m), tax credit (S$19m), and inventory & work-in-progress write back (S$32m), losses would have been c.S$100m, a substantial portion of which we believe was attributable to expected cost overrun for several projects' variation orders as customers have yet agreed to pay. We believe total cost overrun for disputed variation orders exceeded S$100m last year.

Expect gradual improvement. We have slashed our FY18/19 forecasts by 54-58%. Taking the cue from 4Q17, SMM might continue to incur some losses in 1H18 as revenue might remain low until major projects start to kick in, which will take 1-2 quarters to start being recognised. Hopefully, some of the cost overrun for disputed variation orders in 2017 could be recouped this year and better economies of scale from higher activity should be realized towards 2H18.

Orderbook stood at S$7.58bn, as at Dec-2017, with S$1.1bn for Borr Drilling (largely to be recognised in 2018) and c.42% or S$3.2bn from the drillship projects with Sete Brasil (expect reactivation from 2019). The remaining S$3.3bn should largely be recognised in the next two years.

Higher enquiry level but competition is intense. Management has seen increasing enquiries in the production segment but has cautioned that competition for orders remains intense. Its core focus continue to be on production-related and LNG solutions.

Conducting FEED study for Seaone. SMM started FEED study for Seaone's compressed gas carrier in Oct-2017 and expects it to complete in 1H18, following which, the customer will decide on FID for the project. Hence, if FID is achieved, the actual contract award for the two gas carriers estimated at S$800m seems likely to skew towards 4Q18 at the earliest.

Capex likely to trend upward slightly, from S$178m in 2017. Management may proceed with phase 3 development of its Tuas Boulevard Yard in response to business needs. The expected capex should not be more than S$500m.

Net gearing lowered to 1.1x, from 1.3x a quarter ago, largely attributable to the receipt of a US$500m deposit from Borr Drilling.

Declared 1 Sct final dividend, bring full-year dividend payout to 2 Sct. This represents <1% yield. Given the low profitability, we expect a similar payout for the next two years.

Potential new order wins

Sembcorp Marine			
Type	Potential Customer / Project	Est.value (S$ m)	Status
Modularised LNG Exporting Terminal	Poly-GCL	1,000	Advanced talks
Compressed Gas Liquid carriers x2	SeaOne Caribbean	800	LOI
Semisub Production Unit	Shell's Vito	400-800	LOI
Newbuild FPSO	Energean's Karish-Tanin	500	Forerunner
Modularised LNG Importing Terminal	-	200-300	-
FPSO conversion	-	200-300	-

Source: Upstream, Company, DBS Bank

Quarterly / Interim Income Statement (S$m)

FY Dec	4Q2016	3Q2017	4Q2017	% chg yoy	% chg qoq
Revenue	830	317	655	(21.1)	106.7
Cost of Goods Sold	(795)	(304)	(703)	(11.6)	130.9
Gross Profit	34.7	12.4	(48.2)	nm	nm
Other Oper. (Exp)/Inc	32.4	9.58	4.52	(86.0)	(52.8)
Operating Profit	67.1	22.0	(43.6)	(165.1)	(298.2)
Other Non Opg (Exp)/Inc	(16.2)	(1.1)	10.4	nm	nm
Associates & JV Inc	(5.3)	(0.7)	(1.7)	68.3	142.6
Net Interest (Exp)/Inc	(24.3)	(22.0)	(19.2)	20.9	12.7
Exceptional Gain/(Loss)	0.0	0.0	0.0	-	-
Pre-tax Profit	21.3	(1.8)	(54.2)	nm	nm
Tax	9.36	3.42	19.2	105.3	461.4
Minority Interest	3.66	1.06	1.21	(67.1)	13.7
Net Profit	34.3	2.72	(33.8)	nm	nm
Net profit bef Except.	34.3	2.72	(33.8)	nm	nm
EBITDA	98.7	69.9	13.1	(86.7)	(81.3)
Margins (%)					
Gross Margins	4.2	3.9	(7.4)		
Opg Profit Margins	8.1	6.9	(6.7)		
Net Profit Margins	4.1	0.9	(5.2)		

Source of all data: Company, DBS Bank

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.

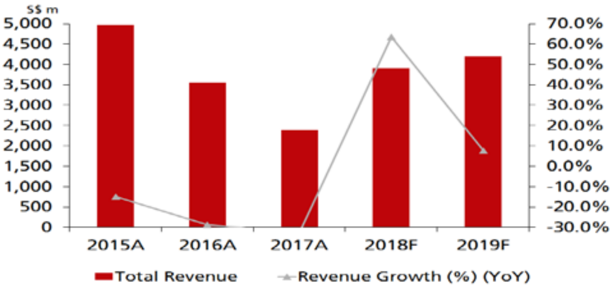
Order-book replenishment. Order wins and order-book trends are often the key drivers of rigbuilders' share prices and earnings. Based on existing capacity, SMM requires ~S$4bn worth of order replenishments every year in an ideal case. We expect new orders to recover to S$3bn in FY18 from the dismal ~S$300m in FY16 and S$1bn in FY17, driven by the new Gravifloat modularised LNG terminal solutions. SMM's net order-book stood at S$7.58bn as at Dec-2017, with c.42% or S$3.2bn from the drillship projects with Sete Brasil and 14% or S$1.1bn for Borr Drilling. 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. We believe a gradual recovery in oil prices and the rig market will set the stage for rising newbuild demand thereafter.

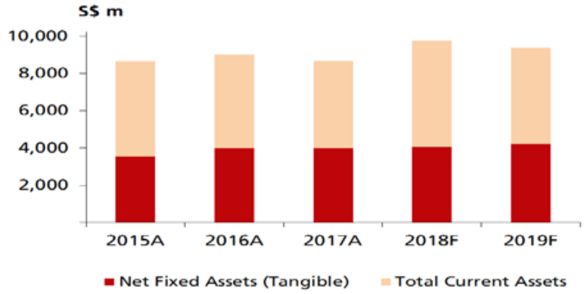
Pace of rigbuilding recovery is dependent on oil price rebound, retirement of old fleet, and cancellations at Chinese yards. Oil price rebounding above US$60/bbl will stimulate E&P activities and thus rig demand, while rig attribution and cancellations will soothe the supply pressure and eventually bring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

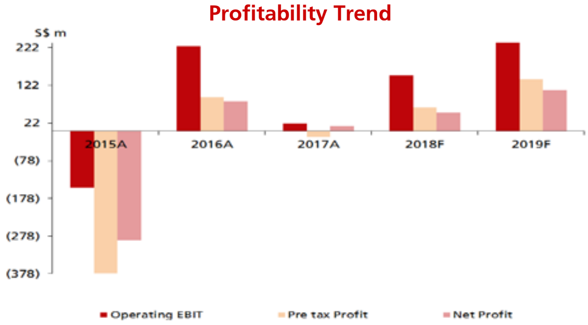
Sales Trend



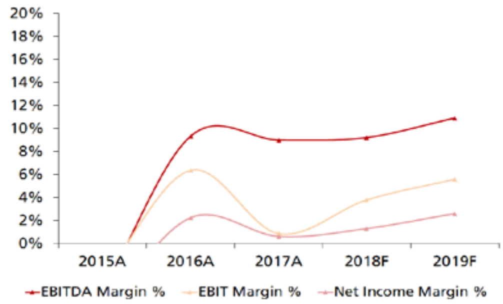
Asset Trend



Profitability Trend



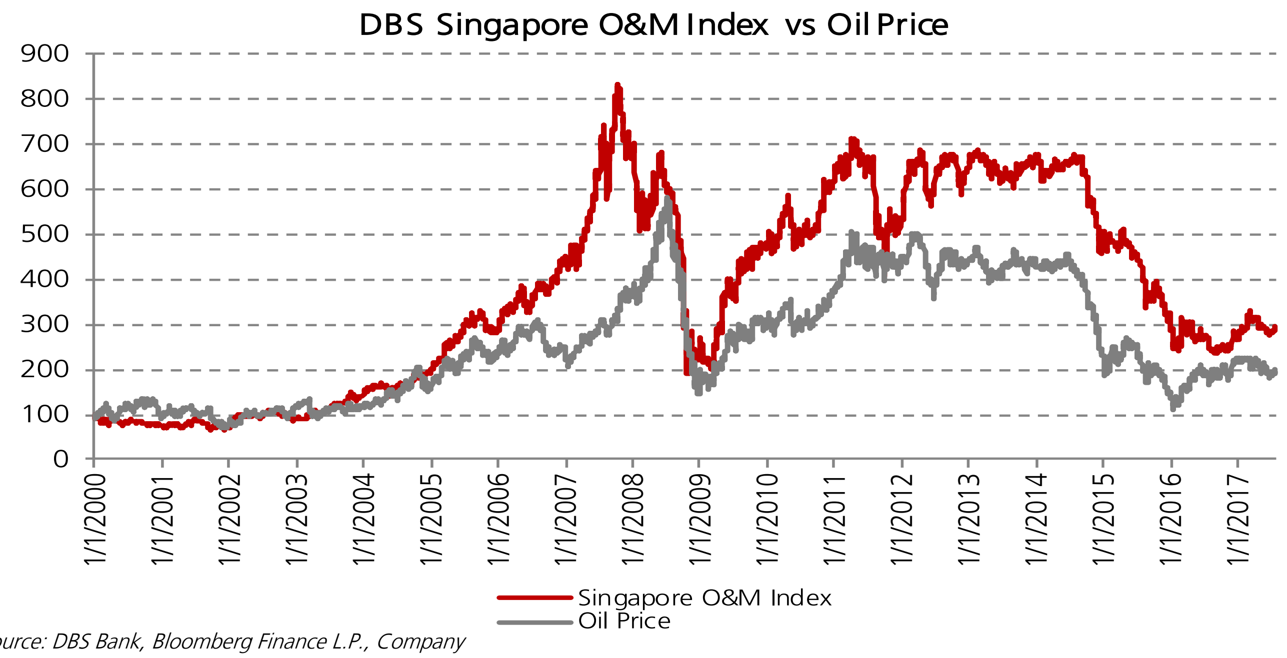
Margin Trends (%)



Source: Company, DBS Bank

Appendix 1:

Singapore Offshore Marine vs Oil Price



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

SMM's valuation vs contract wins

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

Balance Sheet:

Net gearing reduced to 1.1x as at end-Dec 2017, from 1.3x a quarter ago following receipt of Borr's S$500m downpayment in Oct. Gearing 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 normal level ~S$100-200m for maintenance capex and up to S$500m if the Phase 3 development of the New Integrated Yard @ Tuas is kickstarted. Otherwise, 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.

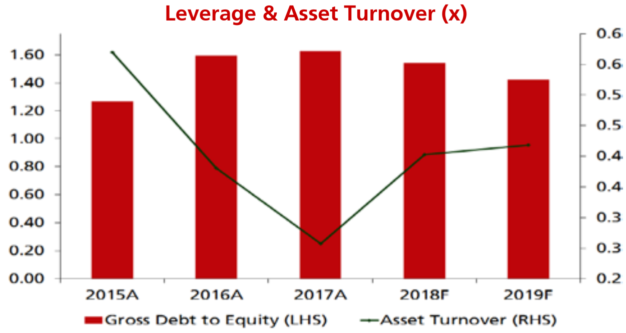
Corruption scandal in Brazil. SMM has initiated an internal investigation against the bribery allegations in Brazil in 2015. The investigation is ongoing, and it is not aware of any irregularities thus far. Meanwhile SMM's in Brazilian agent – Mr Guilherme Esteves de Jesus is defending the charges against him on paying bribes to secure the Drillship contracts and court hearing of the charges is not yet known. The risks of potential financial and reputational loss remain an overhang.

Rig supply glut and competition. A slower order flow is expected, as the market takes time to absorb about 150 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.

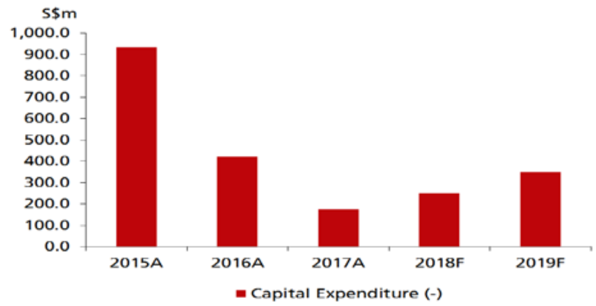
Company Background

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.

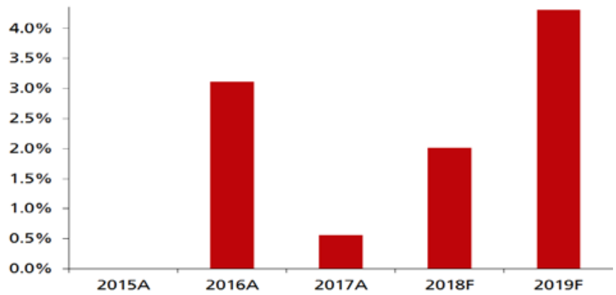
Leverage & Asset Turnover (x)



Capital Expenditure



ROE (%)



PB Band (x)

Source: Company, DBS Bank

Key Assumptions

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

Segmental Breakdown

FY Dec	2015A	2016A	2017A	2018F	2019F
Revenues (S$m)					
Rigs & Floaters	3,319	1,887	1,098	2,673	2,880
Offshore Platforms	1,017	1,116	732	657	709
Repairs & Upgrades	557	460	471	495	533
Specialised Shipbuilding	0.0	0.0	0.0	0.0	0.0
Others	75.8	82.1	86.0	80.0	80.0
Total	4,968	3,545	2,387	3,905	4,202

Income Statement (S$m)

FY Dec	2015A	2016A	2017A	2018F	2019F
Revenue	4,968	3,545	2,387	3,905	4,202
Cost of Goods Sold	(4,837)	(3,252)	(2,327)	(3,694)	(3,891)
Gross Profit	131	293	60.5	210	310
Other Opng (Exp)/Inc	(281)	(67.4)	(40.1)	(62.5)	(75.6)
Operating Profit	(150)	225	20.5	148	235
Other Non Opg (Exp)/Inc	(18.2)	(18.9)	4.69	0.0	0.0
Associates & JV Inc	(173)	(35.1)	(3.6)	5.00	7.00
Net Interest (Exp)/Inc	(36.0)	(80.7)	(84.0)	(89.5)	(104)
Exceptional Gain/(Loss)	0.0	0.0	46.8	0.0	0.0
Pre-tax Profit	(378)	90.5	(15.6)	63.4	138
Tax	77.6	(15.4)	25.6	(11.4)	(24.8)
Minority Interest	10.3	3.62	4.13	(2.1)	(4.5)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	(290)	78.8	14.1	49.9	109
Net Profit before Except.	(290)	78.8	(32.7)	49.9	109
EBITDA	(210)	330	214	359	458
Growth					
Revenue Gth (%)	(14.8)	(28.6)	(32.7)	63.6	7.6
EBITDA Gth (%)	nm	nm	(35.1)	67.5	27.5
Opg Profit Gth (%)	(121.2)	(250.2)	(90.9)	623.2	58.5
Net Profit Gth (Pre-ex) (%)	nm	nm	nm	nm	117.5
Margins & Ratio					
Gross Margins (%)	2.6	8.3	2.5	5.4	7.4
Opg Profit Margin (%)	(3.0)	6.4	0.9	3.8	5.6
Net Profit Margin (%)	(5.8)	2.2	0.6	1.3	2.6
ROAE (%)	(10.6)	3.1	0.6	2.0	4.3
ROA (%)	(3.3)	0.8	0.2	0.5	1.1
ROCE (%)	(2.6)	2.8	0.3	1.8	2.9
Div Payout Ratio (%)	N/A	66.3	296.7	83.6	38.5
Net Interest Cover (x)	(4.2)	2.8	0.2	1.7	2.3

Source: Company, DBS Bank

Quarterly / Interim Income Statement (S$m)

FY Dec	4Q2016	1Q2017	2Q2017	3Q2017	4Q2017
Revenue	830	760	655	317	655
Cost of Goods Sold	(795)	(740)	(579)	(304)	(703)
Gross Profit	**34.7**	**19.9**	**76.3**	**12.4**	**(48.2)**
Other Oper. (Exp)/Inc	32.4	(6.4)	(47.8)	9.58	4.52
Operating Profit	**67.1**	**13.6**	**28.5**	**22.0**	**(43.6)**
Other Non Opg (Exp)/Inc	(16.2)	0.02	(4.6)	(1.1)	10.4
Associates & JV Inc	(5.3)	(0.7)	(0.5)	(0.7)	(1.7)
Net Interest (Exp)/Inc	(24.3)	(22.9)	(19.8)	(22.0)	(19.2)
Exceptional Gain/(Loss)	0.0	46.8	0.0	0.0	0.0
Pre-tax Profit	**21.3**	**36.8**	**3.52**	**(1.8)**	**(54.2)**
Tax	9.36	2.77	0.19	3.42	19.2
Minority Interest	3.66	0.0	1.89	1.06	1.21
Net Profit	**34.3**	**39.5**	**5.59**	**2.72**	**(33.8)**
Net profit bef Except.	34.3	(7.3)	5.59	2.72	(33.8)
EBITDA	98.7	59.9	71.6	69.9	13.1
Growth					
Revenue Gth (%)	(6.5)	(8.4)	(13.8)	(51.7)	106.7
EBITDA Gth (%)	168.5	(39.4)	19.6	(2.3)	(81.3)
Opg Profit Gth (%)	103.7	(79.7)	109.7	(22.7)	(298.2)
Net Profit Gth (Pre-ex) (%)	(257.4)	(121.2)	(177.1)	(51.4)	(1,343.7)
Margins					
Gross Margins (%)	4.2	2.6	11.6	3.9	(7.4)
Opg Profit Margins (%)	8.1	1.8	4.3	6.9	(6.7)
Net Profit Margins (%)	4.1	5.2	0.9	0.9	(5.2)

Balance Sheet (S$m)

FY Dec	2015A	2016A	2017A	2018F	2019F
Net Fixed Assets	3,541	3,987	3,995	4,062	4,218
Invts in Associates & JVs	312	74.8	68.0	73.0	80.0
Other LT Assets	231	335	400	400	400
Cash & ST Invts	690	1,269	1,335	1,376	1,252
Inventory	3,833	3,067	2,776	3,004	2,626
Debtors	590	492	567	1,302	1,273
Other Current Assets	3.89	191	11.2	11.2	11.2
Total Assets	**9,201**	**9,415**	**9,151**	**10,227**	**9,861**
ST Debt	915	1,364	853	853	853
Creditor	2,519	2,120	2,061	3,254	3,001
Other Current Liab	463	264	228	301	317
LT Debt	2,465	2,791	3,247	3,047	2,847
Other LT Liabilities	175	268	242	242	242
Shareholder's Equity	2,511	2,562	2,478	2,486	2,553
Minority Interests	153	45.6	41.2	43.3	47.8
Total Cap. & Liab.	**9,201**	**9,415**	**9,151**	**10,227**	**9,861**
Non-Cash Wkg. Capital	1,445	1,365	1,064	762	593
Net Cash/(Debt)	(2,690)	(2,886)	(2,766)	(2,524)	(2,448)
Debtors Turn (avg days)	38.9	55.7	80.9	87.3	111.8
Creditors Turn (avg days)	168.5	273.7	357.6	278.1	310.6
Inventory Turn (avg days)	265.2	407.1	499.7	302.4	279.6
Asset Turnover (x)	0.6	0.4	0.3	0.4	0.4
Current Ratio (x)	1.3	1.3	1.5	1.3	1.2
Quick Ratio (x)	0.3	0.5	0.6	0.6	0.6
Net Debt/Equity (X)	1.0	1.1	1.1	1.0	0.9
Net Debt/Equity ex MI (X)	1.1	1.1	1.1	1.0	1.0
Capex to Debt (%)	27.6	10.1	4.3	6.4	9.5
Z-Score (X)	1.2	1.2	1.1	1.2	1.3

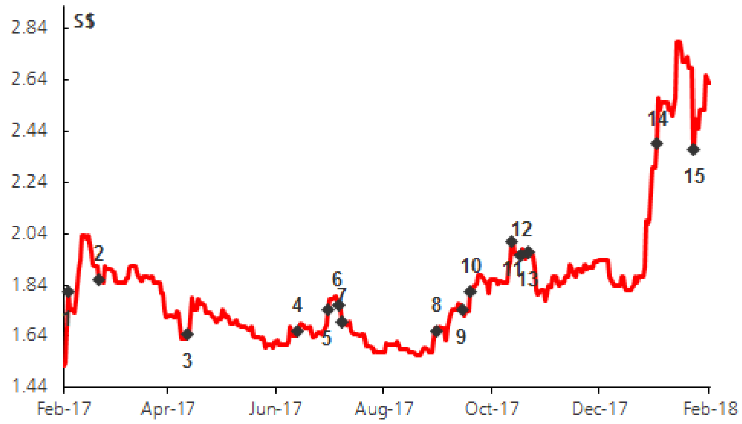
Source: Company, DBS Bank

Cash Flow Statement (S$m)

FY Dec	2015A	2016A	2017A	2018F	2019F
Pre-Tax Profit	(378)	90.5	(15.6)	63.4	138
Dep. & Amort.	132	159	193	183	193
Tax Paid	(104)	(28.0)	(12.6)	(24.9)	(11.4)
Assoc. & JV Inc/(loss)	173	35.1	3.62	(5.0)	(7.0)
Chg in Wkg.Cap.	(291)	284	(59.3)	316	156
Other Operating CF	(521)	27.5	(59.3)	0.0	0.0
Net Operating CF	(989)	569	49.6	533	468
Capital Exp.(net)	(932)	(421)	(176)	(250)	(350)
Other Invts.(net)	0.0	0.0	206	0.0	0.0
Invts 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)	36.1	0.0	0.0
Net Investing CF	(932)	(490)	65.4	(250)	(350)
Div Paid	(265)	(73.7)	(41.8)	(41.8)	(41.8)
Chg in Gross Debt	1,744	768	24.8	(200)	(200)
Capital Issues	(11.3)	(3.0)	0.0	0.0	0.0
Other Financing CF	2.02	(157)	(6.7)	0.0	0.0
Net Financing CF	1,469	534	(23.8)	(242)	(242)
Currency Adjustments	4.71	(22.7)	(7.3)	0.0	0.0
Chg in Cash	(447)	590	84.0	41.1	(123)
Opg CFPS (S cts)	(33.4)	13.6	5.22	10.4	15.0
Free CFPS (S cts)	(92.0)	7.05	(6.1)	13.5	5.67

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:	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
14:	22 Jan 18	2.39	3.10	BUY
15:	12 Feb 18	2.37	3.10	BUY

Source: DBS Bank
Analyst: Pei Hwa HO

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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)
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Share price appreciation + dividends

Completed Date: 22 Feb 2018 09:08:44 (SGT)
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