

Singapore Company Guide

Keppel Infrastructure Trust

Version 7 | Bloomberg: KIT SP | Reuters: KEPL.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

18 Apr 2018

BUY

Last Traded Price (17 Apr 2018): S\$0.545 (STI : 3,498.20)

Price Target 12-mth: S\$0.60 (10% upside)

Analyst

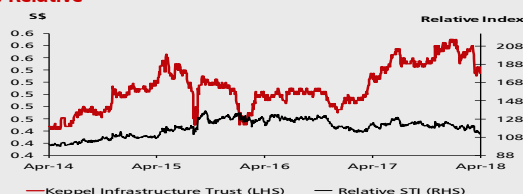
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What's New

- 1Q18 DPU maintained at 0.93 Scts
- Share price dampened owing to negative newsflow from Basslink asset
- We believe KIT is sufficiently ring-fenced from possible legal penalties at Basslink
- Maintain BUY with TP of S\$0.60

Price Relative



Forecasts and Valuation

FY Dec (\$m)	2016A	2017A	2018F	2019F
Revenue	581	632	644	651
EBITDA	237	244	261	262
Pre-tax Profit	6.54	14.1	17.2	18.7
Net Profit	41.2	47.6	52.1	54.6
Net Pft (Pre Ex.)	41.2	47.6	52.1	54.6
Net Pft Gth (Pre-ex) (%)	166.5	15.6	9.5	4.7
EPS (S cts)	1.07	1.23	1.35	1.42
EPS Pre Ex. (S cts)	1.07	1.23	1.35	1.42
EPS Gth Pre Ex (%)	166	16	9	5
Diluted EPS (S cts)	1.07	1.23	1.35	1.42
Net DPS (S cts)	3.72	3.72	3.72	3.72
BV Per Share (S cts)	32.5	29.9	27.5	25.2
PE (X)	51.0	44.1	40.3	38.5
PE Pre Ex. (X)	51.0	44.1	40.3	38.5
P/Cash Flow (X)	25.0	25.6	12.8	12.3
EV/EBITDA (X)	16.2	15.7	14.5	14.3
Net Div Yield (%)	6.8	6.8	6.8	6.8
P/Book Value (X)	1.7	1.8	2.0	2.2
Net Debt/Equity (X)	1.1	1.2	1.3	1.5
ROAE (%)	3.1	4.0	4.7	5.4

Earnings Rev (%): 0 0
 Consensus EPS (S cts): 1.20 1.70
 Other Broker Recs: B: 1 S: 0 H: 1

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

Look beyond Basslink irritant

High dividend visibility remains; maintain BUY. Keppel Infrastructure Trust (KIT) maintained its record of steady DPU of 0.93 Scts in 1Q18, as expected. KIT generated distributable cash flow of S\$36.2m in 1Q18, in line with expectations. Most of KIT's assets derive revenue from availability-based payments, independent of actual offtake. Hence, cash flows are highly predictable and not exposed to economic cycles. Concession agreements are long term in nature, of up to 20 years, and mostly with government entities, thereby minimising risk.

Where we differ. We believe the Trust is sufficiently protected from ongoing troubles at Basslink, where the State of Tasmania is demanding indemnification to the tune of over A\$100m for losses incurred during the Basslink outage in 2016. While Basslink maintains the cable failure was a force majeure event and will vigorously defend its claim in court, if required, even in the worst case scenario, KIT will not be liable to pay any damages as any claims against Basslink are ring-fenced at Basslink level. In any case, KIT does not depend on cash flows from Basslink for current distributions, and project loans are also non-recourse to KIT. We ascribe zero value to Basslink in our valuations for KIT, hence the negative newsflow from Basslink is an irritant at best and does not affect fundamentals for KIT.

Potential catalyst. We look forward to the Trust kicking off its M&A ambitions in the near-to-medium term.

Valuation:

Based on our DDM-based valuation methodology (cost of equity: 5.5%), we derive a valuation of S\$0.60 for KIT. The Trust is currently trading at a healthy yield of 7%, and provides a good entry point for investors, following the recent de-rating owing to negative newsflow emanating from Basslink asset.

Key Risks to Our View:

Key risks include (i) plants not meeting availability thresholds owing to operating issues, (ii) increasing debt refinancing risks for the asset portfolio as the assets age, and (iii) exposure to increases in inflation and interest rates.

At A Glance

Issued Capital (m shrs)	3,858
Mkt. Cap (\$m/US\$m)	2,103 / 1,603
Major Shareholders (%)	
Keppel Corp (%)	18.2
Temasek (%)	15.9
Free Float (%)	71.9
3m Avg. Daily Val (US\$m)	2.1

ICB Industry : Financials / Nonequity Investment Instrument

WHAT'S NEW

Steady dividend payout, but negative newsflow from Basslink dominates

1Q18 distribution of 0.93 Scts in line. Keppel Infrastructure Trust (KIT) declared DPU of 0.93S cts for 1QFY18, another steady quarter, as expected. Group revenue was up 3% y-o-y and 1% q-o-q to S\$160m in 1Q18 and distributable cashflows – the key number for KIT – were up 6% y-o-y and 18% q-o-q to S\$36.2m. This is slightly higher than quarterly distribution of S\$35.9m (0.93 Scts per share) and hence demonstrates sustainability of distributions. This was mainly due to better performance from City Gas, owing to adjustment of gas tariffs in response to higher underlying fuel prices. Cash flows from other key assets remained stable. Basslink continued to generate positive funds from operations, but the Trust does not use these cash flows for distribution purposes, rather for servicing loans.

Meanwhile, dispute between Basslink and counterparties has intensified. KIT's wholly-owned subsidiary Basslink Pty Ltd (Basslink) has received a letter from the State of Tasmania alleging that it had breached the Basslink Operations Agreement (BOA). The BOA governs the contractual relationship between the State and Basslink as the operator of the Basslink Interconnector. The State has alleged that warranties about the design and construction of the Basslink Interconnector were breached, leading to the six-month outage in 2016. The State has also alleged that it has suffered various losses and that Basslink must indemnify it for those losses (including alleged losses incurred by Hydro Tasmania arising from the cable failure in December 2015), amounting to over A\$100m.

Basslink will vigorously defend its position. Basslink understands that the State's allegations stem from the DNV GL reports commissioned by the lawyers for Hydro Tasmania, which were provided to Basslink in December 2017. Basslink has previously noted that DNV GL did not conduct any testing of the Basslink Interconnector's cable and their reports were solely based on theoretical modeling, which has not been shared with Basslink. Basslink continues to stand by the independent investigation that was undertaken by independent cable expert, Cable Consulting International (CCI), who concluded the actual root cause of the cable failure in December 2015 as "cause unknown", and hence, Basslink maintains the cable failure as a force majeure event. Thus, Basslink denies that it is liable for any losses incurred by the State and should the State take these allegations further, Basslink will vigorously defend its position during any possible arbitration proceedings if the dispute is not resolved otherwise.

Long legal battle likely, Basslink sale process on the backburner. Both parties seem unwilling to accept each other's investigations at this point of time and a long legal process seems likely at this point. The most immediate fallout of this is that the sales process initiated by KIT management for the Basslink asset is likely to be derailed indefinitely, pending an outcome of any legal challenge. We view this as a negative development, as a sale of Basslink would have removed a key sentiment overhang for the stock.

In a separate development, Basslink Interconnector is down again for a couple of months. On 28 March 2018, Basslink announced that a third-party contractor damaged a piece of equipment during routine maintenance works which resulted in a service outage. There is no damage to the cable itself. The repair requires specialised expertise and equipment from overseas and Basslink is working to return the interconnector to service. Based on the latest available information, the anticipated return to service date is 31 May 2018. This event is unrelated to the Incident and the ongoing dispute with the State of Tasmania. This will likely again cause some loss of revenue and adds to the negative newsflow surrounding the asset.

KIT is sufficiently ring-fenced from troubles at Basslink. We believe the Trust is sufficiently protected from ongoing issues at Basslink. Even in the worst-case scenario, KIT will not be liable to pay any damages as any claims against Basslink are ring-fenced at Basslink level. In any case, KIT does not depend on cash flows from Basslink for current distributions, and project loans are also non-recourse to KIT. We ascribe zero value to Basslink in our valuations for KIT, hence the negative newsflow from Basslink is an irritant at best and does not affect fundamentals for KIT.

Maintain BUY with TP of S\$0.60. Based on our DDM-based valuation methodology (Cost of Equity – 5.5%), we derive a valuation of S\$0.60 for KIT. The Trust is currently trading at a healthy yield of 7% based on annual distribution forecast of 3.72 Scts in FY18, and provides a better entry point for investors following recent de-rating owing to negative newsflow from Basslink asset.

Acquisitions the key future catalyst. Apart from the ROFR pipeline, management continues to evaluate third-party options in sectors like energy, telecoms, water and waste management. We look forward to the Trust kicking off its M&A ambitions in the next 6-12 months. This should be a key catalyst for further re-rating.

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

FY Dec	1Q2017	4Q2017	1Q2018	% chg yoy	% chg qoq
Revenue	155	158	160	3.2	1.4
Cost of Goods Sold	(122)	(123)	(121)	(1.1)	(2.1)
Gross Profit	33.3	34.9	39.6	19.0	13.4
Other Oper. (Exp)/Inc	(2.6)	(2.3)	(2.6)	2.0	16.0
Operating Profit	30.7	32.7	37.0	20.4	13.3
Other Non Opg (Exp)/Inc	(1.2)	(2.7)	(6.6)	nm	144.3
Associates & JV Inc	0.23	0.91	0.86	277.6	(5.4)
Net Interest (Exp)/Inc	(31.1)	(31.3)	(31.3)	nm	nm
Exceptional Gain/(Loss)	0.0	0.0	0.0	-	-
Pre-tax Profit	(1.4)	(0.4)	(0.1)	nm	nm
Tax	(0.5)	2.77	(1.0)	87.0	(134.9)
Minority Interest	8.67	7.23	8.56	(1.2)	18.4
Net Profit	6.76	9.61	7.50	10.9	(22.0)
Net profit bef Except.	6.76	9.61	7.50	10.9	(22.0)
EBITDA	56.6	56.9	57.3	1.2	0.6
Margins (%)					
Gross Margins	21.4	22.1	24.7		
Opg Profit Margins	19.8	20.6	23.1		
Net Profit Margins	4.4	6.1	4.7		

Source of all data: Company, DBS Bank

Balance Sheet:

Balance sheet leaves headroom for growth. Current gearing levels are not overly aggressive for a utility asset owner, in our view. As of end-1Q18, net leverage was around 40% of assets and net debt/adjusted EBITDA was around 5.7x by our estimates. While there is no statutory cap on gearing levels for Business Trusts in Singapore, we estimate that the Trust could borrow about S\$360m for acquisitions before it hits the 45% leverage, which is the new limit for REITs in Singapore, and acts as a rough benchmark. This would provide the Trust with enough firepower to look at acquisition targets above S\$500m enterprise value range funded by a 2:1 debt:equity mix, in our opinion.

Share Price Drivers:

Management needs to deliver on acquisitions. The premise for combining two existing listed Trusts was to give management more ammunition to pursue accretive acquisitions. Given that organic growth potential is low, investors will look closely at management's ability to execute on the M&A promise.

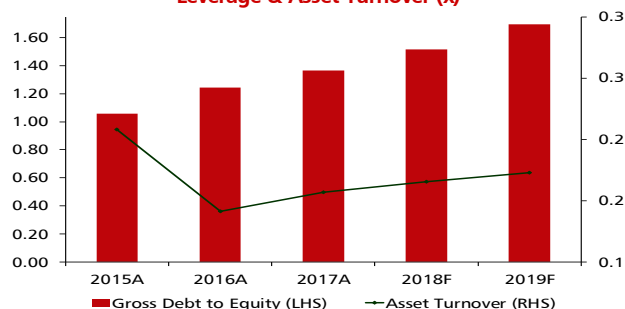
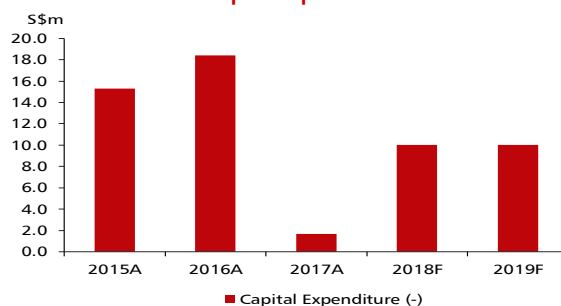
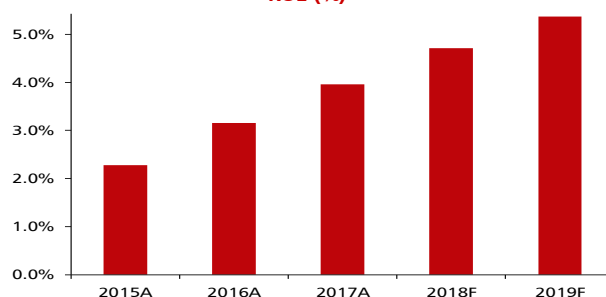
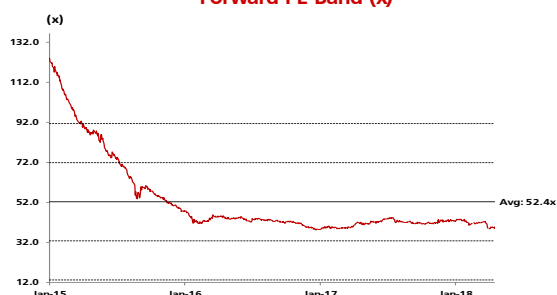
Key Risks:

Key investment risks. We see four key risks: (i) plants not meeting availability thresholds owing to operating issues, (ii) increasing debt refinancing risks for the asset portfolio as the assets age, (iii) volatility in energy prices at certain assets which do not have a full pass-through mechanism, and (iv) exposure to increases in inflation and interest rates.

Basslink outage issues remain, but no immediate impact on DPU. The Basslink Interconnector suffered an undersea cable fault owing to which availability was affected between 20 December 2015 and 13 June 2016. Basslink believes this is a force majeure event, and the insurer has already made advance payments of A\$46m, but offtaker Hydro Tasmania disagrees. The State of Tasmania is also demanding indemnification for losses to the tune of A\$100m. Thus, Basslink will now need to resolve these issues through negotiation or arbitration and also renegotiate its long-term project debt with its banking syndicate. This event however has no impact on KIT's distributions as Basslink has not been contributing to distributable cash flows for a while and is not expected to do so in the near future either.

Company Background

Keppel Infrastructure Trust (KIT) has a diversified portfolio of assets, which derive long-term predictable cash flows from town gas, water management, waste and wastewater management and electricity transmission infrastructure in Singapore and Australia.

Leverage & Asset Turnover (x)**Capital Expenditure****ROE (%)****Forward PE Band (x)****PB Band (x)**

Source: Company, DBS Bank

Income Statement (\$m)

FY Dec	2015A	2016A	2017A	2018F	2019F
Revenue	428	581	632	644	651
Cost of Goods Sold	(346)	(466)	(481)	(489)	(495)
Gross Profit	81.9	115	151	155	156
Other Opng (Exp)/Inc	(7.3)	(9.9)	(9.8)	(9.5)	(9.5)
Operating Profit	74.7	105	142	145	147
Other Non Opg (Exp)/Inc	5.52	18.0	(5.3)	0.0	0.0
Associates & JV Inc	(0.2)	0.71	2.72	3.30	3.30
Net Interest (Exp)/Inc	(78.8)	(117)	(125)	(131)	(131)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	1.16	6.54	14.1	17.2	18.7
Tax	(2.8)	(0.4)	(0.3)	(2.1)	(2.1)
Minority Interest	17.1	35.1	33.8	37.0	38.0
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	15.5	41.2	47.6	52.1	54.6
Net Profit before Except.	15.5	41.2	47.6	52.1	54.6
EBITDA	148	237	244	261	262
Growth					
Revenue Gth (%)	N/A	35.8	8.8	1.8	1.1
EBITDA Gth (%)	nm	60.6	2.9	6.9	0.6
Opg Profit Gth (%)	nm	40.4	35.1	2.6	1.0
Net Profit Gth (Pre-ex) (%)	nm	166.5	15.6	9.5	4.7
Margins & Ratio					
Gross Margins (%)	19.1	19.7	23.9	24.0	24.0
Opg Profit Margin (%)	17.4	18.0	22.4	22.6	22.5
Net Profit Margin (%)	3.6	7.1	7.5	8.1	8.4
ROAE (%)	2.3	3.1	4.0	4.7	5.4
ROA (%)	0.8	1.0	1.2	1.3	1.4
ROCE (%)	(5.2)	2.5	3.6	3.5	3.7
Div Payout Ratio (%)	928.4	348.4	301.4	275.3	262.8
Net Interest Cover (x)	0.9	0.9	1.1	1.1	1.1

Includes Qualified Project Debt Securities (QPDS) interest payments

Minority interest reflects losses from KMC Plant owing to structuring of QPDS debt

Source: Company, DBS Bank

Quarterly / Interim Income Statement (\$m)

FY Dec	1Q2017	2Q2017	3Q2017	4Q2017	1Q2018
Revenue	155	159	160	158	160
Cost of Goods Sold	(122)	(117)	(118)	(123)	(121)
Gross Profit	33.3	41.4	41.8	34.9	39.6
Other Oper. (Exp)/Inc	(2.6)	(2.3)	(2.6)	(2.3)	(2.6)
Operating Profit	30.7	39.1	39.2	32.7	37.0
Other Non Opg (Exp)/Inc	(1.2)	(0.7)	(0.6)	(2.7)	(6.6)
Associates & JV Inc	0.23	0.75	0.83	0.91	0.86
Net Interest (Exp)/Inc	(31.1)	(31.1)	(31.5)	(31.3)	(31.3)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	(1.4)	8.00	7.91	(0.4)	(0.1)
Tax	(0.5)	(1.1)	(1.5)	2.77	(1.0)
Minority Interest	8.67	8.82	9.12	7.23	8.56
Net Profit	6.76	15.8	15.5	9.61	7.50
Net profit bef Except.	6.76	15.8	15.5	9.61	7.50
EBITDA	56.6	65.1	65.5	56.9	57.3

Growth

Revenue Gth (%)	2.0	2.3	0.9	(1.3)	1.4
EBITDA Gth (%)	0.4	15.0	0.6	(13.2)	0.6
Opg Profit Gth (%)	9.3	27.2	0.3	(16.7)	13.3
Net Profit Gth (Pre-ex) (%)	(11.8)	133.1	(1.6)	(38.0)	(22.0)

Margins

Gross Margins (%)	21.4	26.1	26.1	22.1	24.7
Opg Profit Margins (%)	19.8	24.6	24.4	20.6	23.1
Net Profit Margins (%)	4.4	9.9	9.7	6.1	4.7

Balance Sheet (\$m)

FY Dec	2015A	2016A	2017A	2018F	2019F
Net Fixed Assets	2,456	2,380	2,256	2,154	2,051
Invt in Associates & JVs	21.4	23.4	20.8	24.1	27.4
Other LT Assets	1,159	1,199	1,192	1,147	1,102
Cash & ST Invt	244	267	214	224	242
Inventory	56.0	54.5	54.2	60.4	61.0
Debtors	90.5	119	143	143	145
Other Current Assets	89.2	76.5	76.8	76.8	76.8
Total Assets	4,115	4,119	3,956	3,829	3,705
ST Debt	29.7	752	722	722	722
Creditor	144	160	175	178	180
Other Current Liab	29.5	25.0	21.8	20.5	20.5
LT Debt	1,665	1,059	1,072	1,072	1,072
Other LT Liabilities	647	669	654	654	654
Shareholder's Equity	1,360	1,255	1,153	1,062	973
Minority Interests	241	199	159	122	84.0
Total Cap. & Liab.	4,115	4,119	3,956	3,829	3,705
Non-Cash Wkg. Capital	61.9	64.7	77.6	82.2	82.5
Net Cash/(Debt)	(1,451)	(1,544)	(1,580)	(1,570)	(1,553)
Debtors Turn (avg days)	38.6	65.7	75.6	81.2	80.7
Creditors Turn (avg days)	94.6	157.5	162.6	170.6	170.3
Inventory Turn (avg days)	36.7	57.1	52.7	55.4	57.9
Asset Turnover (x)	0.2	0.1	0.2	0.2	0.2
Current Ratio (x)	2.4	0.6	0.5	0.5	0.6
Quick Ratio (x)	1.6	0.4	0.4	0.4	0.4
Net Debt/Equity (X)	0.9	1.1	1.2	1.3	1.5
Net Debt/Equity ex MI (X)	1.1	1.2	1.4	1.5	1.6
Capex to Debt (%)	0.9	1.0	0.1	0.6	0.6
Z-Score (X)	0.6	0.4	0.4	0.4	0.4

NAV will continue to decline as distributions exceed accounting profits

Source: Company, DBS Bank

Cash Flow Statement (\$m)

FY Dec	2015A	2016A	2017A	2018F	2019F
Pre-Tax Profit	1.16	6.54	14.1	17.2	18.7
Dep. & Amort.	67.7	114	105	112	112
Tax Paid	(8.4)	(8.6)	(5.4)	(3.4)	(2.1)
Assoc. & JV Inc/(loss)	0.17	(0.7)	(2.7)	(3.3)	(3.3)
Chg in Wkg.Cap.	(16.1)	(42.6)	(55.9)	(3.3)	(0.3)
Other Operating CF	3.73	15.8	27.2	44.5	45.5
Net Operating CF	48.3	84.2	82.2	164	171
Capital Exp.(net)	(15.3)	(18.4)	(1.7)	(10.0)	(10.0)
Other Invt.(net)	0.0	0.0	0.0	0.0	0.0
Invt in Assoc. & JV	(5.3)	(1.7)	2.14	0.0	0.0
Div from Assoc & JV	0.0	0.0	2.18	0.0	0.0
Other Investing CF	0.02	0.71	0.62	0.0	0.0
Net Investing CF	(20.5)	(19.4)	3.27	(10.0)	(10.0)
Div Paid	(127)	(143)	(143)	(144)	(144)
Chg in Gross Debt	(414)	105	7.66	0.0	0.0
Capital Issues	521	0.0	0.0	0.0	0.0
Other Financing CF	38.6	(2.8)	(2.5)	0.0	0.0
Net Financing CF	18.4	(41.5)	(138)	(144)	(144)
Currency Adjustments	(0.5)	(0.1)	(0.1)	0.0	0.0
Chg in Cash	45.8	23.2	(52.9)	10.4	17.3
Opg CFPS (\$ cts)	1.67	3.29	3.58	4.34	4.43
Free CFPS (\$ cts)	0.86	1.70	2.09	3.99	4.17

Source: Company, DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	18 Apr 17	0.53	0.56	BUY
2:	19 Jul 17	0.57	0.60	BUY
3:	17 Oct 17	0.56	0.60	BUY
4:	23 Jan 18	0.58	0.60	BUY

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

Source: DBS Bank

Analyst: Suvro Sarkar
Glenn NG

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

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