Singapore

Flash Note

Refer to important disclosures at the end of this report

DBS Group Research . Equity   16 Nov 2018

Keppel Infrastructure Trust (KIT SP) : BUY

Mkt. Cap: US$1,287m I **3m Avg. Daily Val:** US$1.5m

Last Traded Price (15 Nov 2018): S$0.46

Price Target 12-mth: S$0.58 (27% upside) (Prev S$0.58)

Company Guide

Summary of our point of view, and highlights the relevant data points, which are actively tracked

Keppel Infrastructure Trust- iBanking Login
Keppel Infrastructure Trust- Institution Login

Analyst

Suvro Sarkar +65 81893144; suvro@dbs.com

Delivers on acquisition promise

- Announces agreement to acquire Ixom, a leading producer and distributor of chemicals in Australia
- EV of A$1.1bn implies 8.2x FY18 EV/EBITDA, a fair valuation compared to peers
- No immediate DPU accretion from the deal, but promise of steady longer term growth in cash flows

Forecasts and Valuation

FY Dec (S$m)	2017A	2018F	2019F	2020F
Revenue	632	642	675	675
EBITDA	244	227	240	234
Pre-tax Profit	14.1	(10.7)	2.33	(3.1)
Net Profit	47.6	22.2	35.2	31.8
Net Pft (Pre Ex.)	47.6	22.2	35.2	31.8
Net Pft Gth (Pre-ex) (%)	15.6	(53.5)	59.0	(9.7)
EPS (S cts)	1.23	0.57	0.91	0.82
EPS Pre Ex. (S cts)	1.23	0.57	0.91	0.82
EPS Gth Pre Ex (%)	16	(53)	59	(10)
Diluted EPS (S cts)	1.23	0.57	0.91	0.82
Net DPS (S cts)	3.72	3.72	3.72	3.72
BV Per Share (S cts)	29.9	26.7	23.9	21.0
PE (X)	37.3	80.1	50.4	55.8
PE Pre Ex. (X)	37.3	80.1	50.4	55.8
P/Cash Flow (X)	21.6	13.8	12.2	12.4
EV/EBITDA (X)	14.4	16.8	15.8	16.0
Net Div Yield (%)	8.1	8.1	8.1	8.1
P/Book Value (X)	1.5	1.7	1.9	2.2
Net Debt/Equity (X)	1.2	1.6	1.9	2.2
ROAE (%)	4.0	2.0	3.6	3.7

Note; Forecasts do not factor in the acquisition yet
Source of all data on this page: Company, DBS Bank, Bloomberg Finance L.P.

What's New

Acquisition announced finally. KIT announced that it has agreed to acquire 100% of the shares in Australian chemical supplier Ixom HoldCo Pty Ltd (Ixom) for an enterprise value of A$1.1bn (approx. S$1.1bn) from existing shareholders which include Blackstone-managed funds and management shareholders.

Ixom has an established track record in Australia and New Zealand and supplies and distributes water treatment chemicals, as well as industrial and specialty chemicals, such as liquefied chlorine, chlorine derivatives and caustic soda (chlor-alkali). The Ixom Group can trace its roots all the way back to the 1920s.

Leading presence in certain chemicals. The Ixom Group is the sole manufacturer of liquefied chlorine in Australia, as well as a leading provider of manufactured caustic soda. The Ixom Group is also one of the largest bulk and packaged chemical distribution businesses in Australia and New Zealand, dealing in chemicals such as sulphuric and nitric acids. The chemicals manufactured and distributed by the Ixom Group are used in a range of industries which have favourable demand outlooks, including water treatment, dairy and agriculture, mining, construction and nickel refining.

Asset intensive business, difficult to replicate. Management estimates 80% of EBITDA is infrastructure-backed, as the business is supported by a large network of well-positioned infrastructure, which includes bulk liquid storage facilities and chlor-alkali manufacturing facilities throughout key regions in Australia and New Zealand, with dedicated third party bulk tankers in select regions to support the import, manufacturing and distribution of water treatment chemicals. The two key production facilities are located in Sydney and Melbourne in Australia. Most of the infrastructure is in close proximity to key ports, airports and customers.

Key Assets/ facilities of Ixom

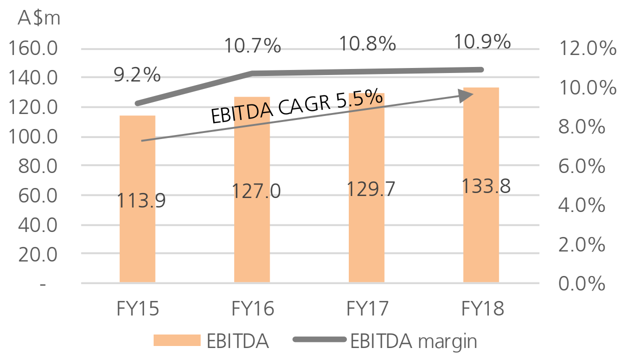
Asset/ Facility	Australia	New Zealand
Bulk liquids storage terminals	14	5
Bulk storage tank sites	38	16
Chlor-alkali manufacturing facilities	2	-

Source: Company

Decent organic growth potential. The chemicals manufactured and distributed by the Ixom Group include liquefied chlorine (which is used in the water treatment process), caustic soda (which is used in the "cleaning in place" process to remove fatty oils and protein solids in dairy products) and hydrochloric acid (which is used in the nickel refining process, involving leaching nickel from ore with hydrochloric acid) – hence, the growth rate will be roughly in proportion to overall Australian GDP growth rate, population growth in Australia and the growth of the dairy trade in Australia and New Zealand, which accounts for 44% of world dairy trade, according to Dairy Australia Limited. We estimate these drivers point to at least 2-4% organic CAGR for the Ixom Group's business, going forward. In the last 4 years, the Group's EBITDA has grown at a clip of 5.5% CAGR.

Stable cash flow profile. The chemicals manufactured and distributed by the Ixom Group, being key chemicals to fundamental industries, leads to a general preference by its customers to enter into long-term contracts of typically 3-5 years to ensure certainty of supply. Hence, there is good element of predictability in the business as far as volumes are concerned. Pricing-wise, there is only risk to a part of caustic soda distribution business that depends on imports, whereas rest of the business is largely cost plus fixed margins. Customer base is varied and no single customer of the Ixom Group contributed more than 6% of total revenue in FY18 and top 10 customers only contributed 15% of revenue, hence counterparty risks are limited as well.

EBITDA and EBITDA margin trend of Ixom



Source: Company

How does Ixom fit into KIT's portfolio? KIT's existing portfolio comprises of assets that generate steady long-term cash flows, and the Ixom acquisition fits in with the strategy to acquire such assets and with a growth kicker on top. The asset most closely matches the City Gas asset in KIT's existing portfolio, as both are distribution businesses with multiple customers, though it must be argued that City Gas is a clear monopoly asset with very limited downside risks other than technology obsolescence. There is no fixed life of the Ixom business unlike some of the concession assets in the portfolio, and this also helps lengthen the effective average remaining life of KIT's asset portfolio.

Size comparisons. Ixom's FY18 EBITDA of A$133m would boost KIT's FY18 adjusted EBITDA by slightly more than 50% and Ixom's EBITDA would constitute about 35% of KIT's overall combined adjusted EBITDA (including Ixom). In terms of assets, Ixom would constitute 31% of total assets (including Ixom) and would change the EBITDA by geography mix from 80:20 Singapore: Australia to 52:48 Singapore: ANZ (Australia New Zealand).

Acquisition price. The Enterprise Value (EV) of the deal of A$1.1bn corresponds to 8.2x EV/EBITDA multiple based on FY18 EBITDA of around A$133m. The equity purchase price is A$777m (~S$775m) and there is gross debt of A$432m on Ixom's balance sheet as of 31 July 2018. The equity purchase price corresponds to a FY17 P/E ratio of roughly

15.2x and FY18 P/E ratio of roughly 17.7x (based on annualised 9M18 numbers). These valuation numbers look pretty fair to us, and in line with other chemicals, fertilisers, paints, explosives distributors listed in Australia and similar sized peers in the region (see table on last page).

How will it be funded? The transaction will be funded with debt initially and a mix of debt and equity eventually. Initially, there will be a Bridge Facility at corporate level – up to S$750m (A$752m) – and AUD 5-year senior secured debt funding of A$532m (S$531m). The Term Loan will be used to repay existing debt of A$432m on Ixom's balance sheet and remaining A$100m will be used to pay a portion of the purchase price. The remaining portion of the purchase price will be initially funded with the Bridge Facility, which will then be repaid with proceeds from Equity Fund Raising (EFR) exercise, details of which are not yet finalised. Likely amount of EFR will be around A$600m (S$600m). That would imply 13:87 debt:equity mix to fund the purchase price.

What will the EFR look like? The structure and timing of the EFR exercise have not been determined by KIT's management yet. Subject to prevailing market conditions, it may be a combination of one or more of:

i) a non-renounceable preferential offering of new Units to eligible existing Unitholders on a pro rata basis (Preferential Offering)
ii) a renounceable rights issue of new Units to eligible existing Unitholders on a pro rata basis (Rights Issue)
iii) a Preferential Offering and a private placement of new Units to institutional and other investors (Placement).

Parent company undertaking in place with respect to proposed EFR. Keppel Infrastructure Holdings Pte. Ltd. (KIHPL), which holds approximately 18.2% of all units in KIT, intends to subscribe for its pro rata entitlement under the Preferential Offering and/or the Rights Issue, as the case may be. If and to the extent a Placement is undertaken, KIHPL intends to take part in the Placement so as to maintain its unitholding of approximately 18.2% in KIT after the Equity Fund Raising.

Financial effects post acquisition and proposed EFR

	Actual as of end-3Q18	After Acquisition & EFR	
		Scenario 1: Preferential Offering & Placement at illustrative price of S$0.43 per unit	Scenario 2: Rights Issue at illustrative price of S$0.30 per unit
No of units in issue (m)	3858.3	5249.9	5865.4
NAV of KIT Group (Scts)	27.9	30.7	27.5
Annualised DPU (Scts)	3.72	3.72	3.45
Dividend yield (%)	8.1%	8.7% for new unitholders, no change for existing ones who do not take up preferential offering or participate in placement	8.6% based on theoretical ex-rights price of S$0.40 per unit under assumed rights issue price of S$0.30 per unit
Annualised distribution implied (DPU x units in issue) (S$m)	143.5 (A)	195.3 (B)	202.4 (C)
Annualised funds from operations (FFO) (S$m)	157.0 (D)	218.0 (E)	218.0 (F)
Excess annualised distribution implied after acquisition (S$m)	N/A	51.8 (B-A)	58.9 (C-A)
Incremental FFO after acquisition (S$m)	N/A	61.0 (E-D)	61.0 (F-D)
Gearing (net debt/ assets) of KIT	40.2%	41.0%	41.0%

Source: Company, DBS Bank

No absolute DPU accretion immediately. Impact to financials is summarised in above table under a couple of different scenarios: 1) Preferential Offering & Placement at illustrative price of S$0.43 per unit, and 2) Rights Issue at illustrative price of S$0.30 per unit. Incremental Funds from Operations from Ixom is estimated to be around S$61m in FY18, but management may choose not to pay out everything and reserve some cash for debt principal servicing and other requirements.

In the first scenario, management will look to maintain annual DPU at current level of 3.72Scts after the EFR, which won't affect yield for existing shareholders but will imply somewhat higher yield for new investors who get a slight discount to prevailing market price. In the second scenario of rights issue, absolute DPU is expected to decline owing to the higher number of shares issued, but given the rights price will be at significant discount to prevailing price, existing minority shareholders will still be able to enjoy enhanced DPU yield owing to lower average theoretical ex-rights price if they choose to exercise their rights. Hence, we believe despite the DPU dilution, rights issue may be more attractive scenario for existing minority shareholders.

Balance sheet will not be affected materially. Since the purchase price will be met with higher equity proportion after EFR, gearing (net debt/ asset) will remain stable at around 0.41x, while net debt to EBITDA metric will actually improve – decline from around 7.0x currently to 5.7x by FY20, if the EFR is successfully completed to raise S$600m.

Our overall views on the transaction are as follows:

1) We believe the transaction may not immediately appeal to unitholders as there is no immediate DPU accretion and DPU yield accretion will only happen in the case of EFR through a rights issue at a significant discount to prevailing market price
2) Management wishes to focus on total returns to unitholders comprising distributions and capital returns from growth, but we believe distribution growth is the most important driver of share price growth for Business Trust structures
3) Nevertheless, we believe the deal is a step in the right direction from KIT management as it diversifies the asset base, stabilises NAV decline, lengthens the effective life of the Trust and creates organic growth potential which was largely missing till now
4) Valuations look reasonable and much lower than what KIT itself is trading at in terms of EV/EBITDA, so doesn't look like management is overpaying for the asset
5) Conserving some cash from Ixom and not paying out 100%of FFO may come in handy to weather the storm in Australia from long term problem asset Basslink in case things turn really ugly there sometime in the future after long drawn out arbitration proceedings, or if KIT needs to cough up some equity when next round of debt refinancing comes up at Basslink.

We are not factoring in the deal in our model until transaction is completed and mode of EFR finalised. Deal completion is estimated to take place in or about the first quarter of 2019, with a cut-off date of 18 April 2019. It needs to get approval from the Australian Foreign Investment Review Board, the New Zealand Overseas Investment Office, and approval from shareholders for firstly the acquisition and if the acquisition is approved, for the EFR plan.

As an illustration, if we were to factor in 9 months contribution in FY19 and full year contribution in FY20, our adjusted EBITDA estimate would be boosted by around 35% in FY19 and 49% in FY20. Net profit estimates in FY19/20 will also go up from around S$30-35m range to S$65-75m range, after factoring in higher management fees post the transaction. Valuations will need to factor in higher equity beta up post transaction to reflect new asset type, and the significant dilution (~ 50%) of share base under rights issue scenario.

Maintain BUY with unchanged TP of S$0.58, given the attractive yield of more than 8% at current prices, and the potential for future DPU growth if the new business performs to expectations and financing is well structured.

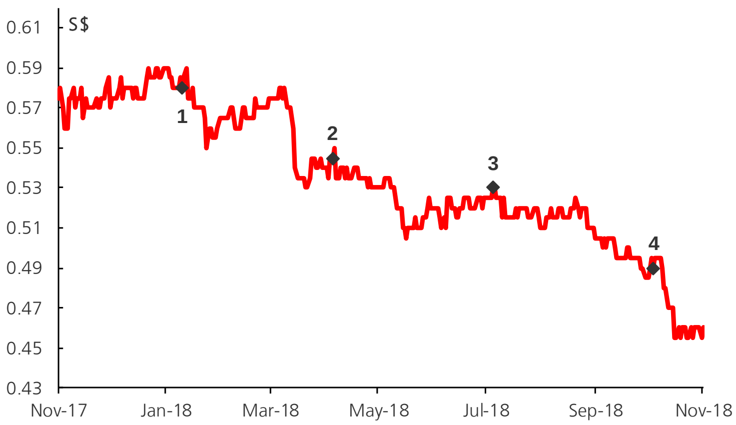
Selected Peer Comparables

Company	FY ending	Enterprise Value (US$m)	EV/ Sales		P/E		EV/EBITDA	
			T12M	Curr Yr	T12M	Curr Yr	T12M	Curr Yr
Australian names								
Incitec Pivot	Sep	5,904	2.1x	2.0x	30.8x	14.8x	14.5x	8.4x
Orica Ltd	Sep	6,063	1.5x	1.5x	N/A	18.3x	16.6x	8.8x
DuluxGroup Ltd	Sep	2,315	1.8x	1.7x	18.3x	18.4x	13.0x	11.6x
Nufarm Ltd	July	2,819	1.2x	1.1x	N/A	14.2x	13.4x	7.6x
Mean			1.7x	1.6x	24.5x	16.4x	14.4x	9.1x
Median			1.7x	1.6x	24.5x	16.5x	14.0x	8.6x
			FY17	FY18	FY17	FY18	FY17	FY18
Ixom	Sep	1,100	0.9x	0.9x	15.2x	17.6x*	8.5x	8.2x
Other regional names of similar size								
Oriental Union	Dec	1,211	1.4x	1.2x	11.5x	9.7x	9.3x	7.5x
Sumitomo Seika	Mar	657	0.9x	N/A	10.6x	10.4x	6.1x	N/A
China Bluechem	Dec	960	0.7x	0.6x	23.0x	8.3x	2.6x	2.7x
Taiwan Fertilizer	Dec	1,085	3.1x	2.8x	22.3x	20.2x	16.8x	N/A
Chambal Fertiliser	Mar	1,799	1.7x	1.6x	11.9x	12.3x	15.1x	16.3x
Sinofert Holding	Dec	1,042	0.3x	0.3x	N/A	13.1x	N/A	6.2x
Coromoandel Int'l	Mar	1,980	1.6x	1.1x	18.5x	16.8x	14.4x	10.3x
Mean			1.4x	1.3x	16.3x	13.0x	10.7x	8.6x
Median			1.4x	1.1x	15.2x	12.3x	11.8x	7.5x

** Annualising 9M18 net profit number for FY18 for Ixom, actual FY18 net profit number could be different*

Source: DBS Bank

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	23 Jan 18	0.58	0.60	BUY
2:	18 Apr 18	0.55	0.60	BUY
3:	18 Jul 18	0.53	0.58	BUY
4:	17 Oct 18	0.49	0.58	BUY

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

Source: DBS Bank
Analyst: Suvro Sarkar

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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)
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Share price appreciation + dividends

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DBS Regional Research Offices

HONG KONG
DBS (Hong Kong) Ltd
Contact: Carol Wu
11th Floor The Center
99 Queen's Road Central
Central, Hong Kong
Tel: 852 3668 4181
Fax: 852 2521 1812
e-mail: dbsvhk@dbs.com

THAILAND
DBS Vickers Securities (Thailand) Co Ltd
Contact: Chanpen Sirithanarattanakul
989 Siam Piwat Tower Building,
9th, 14th-15th Floor
Rama 1 Road, Pathumwan,
Bangkok Thailand 10330
Tel. 66 2 857 7831
Fax: 66 2 658 1269
e-mail: research@th.dbs.com
Company Regn. No 0105539127012
Securities and Exchange Commission, Thailand

MALAYSIA
AllianceDBS Research Sdn Bhd
Contact: Wong Ming Tek (128540 U)
19th Floor, Menara Multi-Purpose,
Capital Square,
8 Jalan Munshi Abdullah 50100
Kuala Lumpur, Malaysia.
Tel.: 603 2604 3333
Fax: 603 2604 3921
e-mail: general@alliancedbs.com

INDONESIA
PT DBS Vickers Sekuritas (Indonesia)
Contact: Maynard Priajaya Arif
DBS Bank Tower
Ciputra World 1, 32/F
Jl. Prof. Dr. Satrio Kav. 3-5
Jakarta 12940, Indonesia
Tel: 62 21 3003 4900
Fax: 6221 3003 4943
e-mail: research@id.dbsvickers.com

SINGAPORE
DBS Bank Ltd
Contact: Janice Chua
12 Marina Boulevard,
Marina Bay Financial Centre Tower 3
Singapore 018982
Tel: 65 6878 8888
Fax: 65 65353 418
e-mail: equityresearch@dbs.com
Company Regn. No. 196800306E