Singapore Industry Focus
Shipbuilding

Refer to important disclosures at the end of this report

DBS Group Research . Equity

1 Feb 2019

Merger on the cards ?

- Hyundai signs MOU to acquire Daewoo to create global shipbuilding powerhouse
- Reduces competition; positive for newbuild prices
- News to reignite speculation on yard mergers in Singapore and China
- BUY Sembcorp Marine (SMM) and Yangzijiang

HHI+DSME = shipbuilding powerhouse. Hyundai Heavy Industries (HHI) has signed a conditional MOU with Korean Development Bank (KDB) to take over the latter's 55.7% stake in DSME in a share-swap deal. If this goes ahead, the combined entity will command >20% market share of global shipbuilding backlog.

Yard mergers on the cards in China and Singapore too? The Korean yard merger substantiates our thesis of continued consolidation in the shipbuilding sector. Recall that the Chinese government reportedly approved the merger of its two largest SOE yards – CSIC and CSSC - last year, but there have been no update since. A similar speculation for Singapore rigbuilders could also be reignited. We believe consolidation will accelerate industry recovery, phasing out excess capacity, alleviate competition, and boost pricing power eventually.

Buy the beneficiaries of industry consolidation. In the event of a merger speculation, SMM (TP S$2.40; +50%) could re-rate on anticipation of it being a privatisation / takeover target. In any case, we believe the current level is a good entry point for SMM as: 1. We expect management tone to turn more positive as activity level, revenue and profitability are trending up; 2) optimism on new contracts for production platform in particular FPSOs for Brazil; 3) M&A angle.

Yangzijiang (TP S$1.82; +30%) is a prime beneficiary of industry consolidation and shipbuilding recovery. Its move into the LNG carrier space through partnership with Japanese yard Mitsui will pave their way into a new market. In addition, the stock offers a decent 3.5% dividend yield.

STI : 3,190.17

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

Singapore Research Team
equityresearch@dbs.com..

STOCKS

	Price S$	Mkt Cap US$m	12-mth Target Price S$	Performance (%) 3 mth	12 mth	Rating
Keppel Corporation	6.10	8,206	NR	(2.4)	(30.4)	NR
Sembcorp Industries	2.59	3,431	3.70	(8.8)	(24.9)	BUY
Sembcorp Marine	1.60	2,480	2.40	(0.6)	(36.8)	BUY
Yangzijiang Shipbuilding	1.40	4,100	1.82	10.2	(11.4)	BUY

Source: DBS Bank, Bloomberg Finance L.P.
Closing price as of 31 Jan 2019

What is happening?

Hyundai Heavy Industries (HHI), the world's largest shipbuilding company, **has indicated interest in acquiring its rival**, the second largest Korean shipbuilder - **Daewoo** Shipbuilding & Marine Engineering Co., Ltd (DSME).

HHI has signed a conditional MOU with Korean Development Bank (KDB) to take over the latter's 55.7% stake in DSME via the issue of matching convertible preferred stocks and common shares in merged entity. The deal includes KDB's liquidity support of 2.5 trillion won (US$2.25bn) for DSME.

KDB said it would also approach Korea's third largest shipbuilding company - **Samsung Heavy Industries** Co Ltd (SHI) - to gauge any interest in taking over DSME.

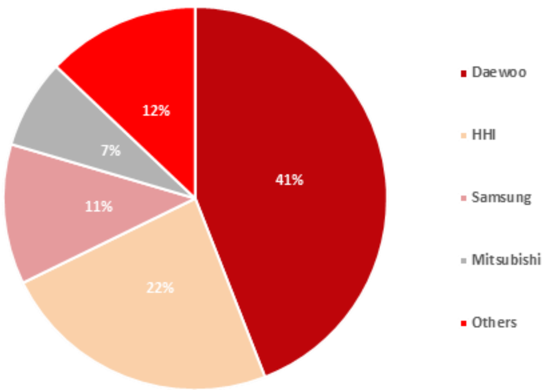
What is the rationale?

The move comes amid **growing calls the reform the Korean shipbuilding industry** from the current big three— HHI, DSME and SHI— to two, to enhance **competitiveness against global competitors from China and Singapore** such as China State Shipbuilding (CSSC), China Shipbuilding Industry (CSIC), Sembcorp Marine (SMM).

The merger of HHI+DSME seems to make more sense than SHI+DSME given the overlap in HHI's and DSME's shipbuilding products in particular liquefied natural gas (LNG) ships, very large crude carriers (VLCCs) and naval vessels, as SHI is more focused on offshore projects.

Additionally, we believe one of the chief reasons for HHI's interest in Daewoo is attributable to Daewoo's global leadership in LNG carriers. Growing dependence on natural gas and elevated global LNG trade would drive new orders in the future.

Breakdown of global LNG carrier backlog



Source: Bloomberg Finance L.P.

What is the impact?

HHI+DSME = shipbuilding powerhouse. If merged, the combined entity will boast a combined shipbuilding backlog of ~US$49bn, dwarfing all other players in the industry with >20% market share.

Lift in newbuild prices. Industry consolidation helps to trim excess capacity, alleviate competition and translate into stronger pricing power for the survivors. In this case, DSME has historically been very aggressive in their pricing strategy in order to fill the yards. The merger should lift newbuild prices, in particular Korean dominated products, moving forward.

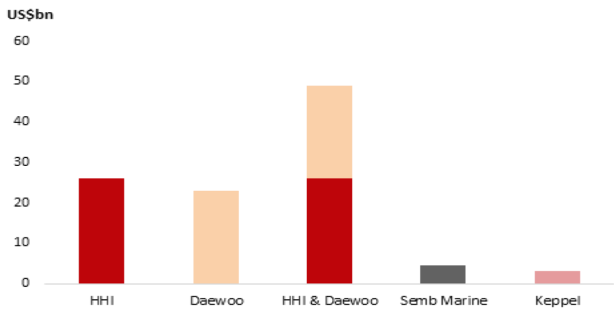
This event **substantiates our thesis of continued consolidation in the shipbuilding sector**. Recall the Chinese government reportedly approved the merger of the two largest SOE yards – CSIC and CSSC - last year, but there have been no updates since. There was also similar speculation for Singapore rigbuilders early last year.

Could a merger of Singapore rigbuilders be on the cards?

Singapore rigbuilders merger speculation resurfaces… Following news of the merger of CapitaLand and Ascendas Singbridge on 14 Jan 2019, and now HHI+DSME, there could be renewed speculation of a merger between SMM and KOM. We did a scenario analysis on this in our thematic report dated 20-Jul-2017 Asian Insights SparX: Shipyards: Creating Global Champions

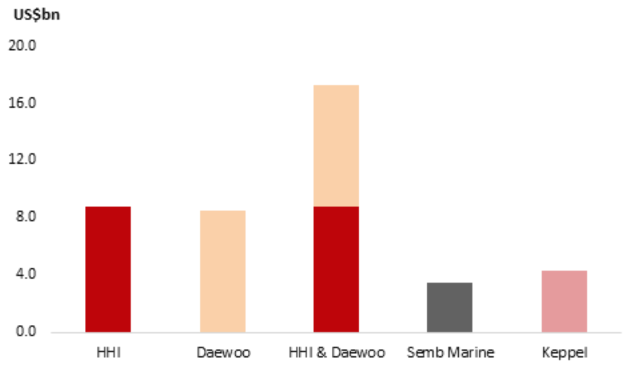
Merger of KOM and SMM could bring capacity and revenue closer to Korean peers. To get a sense of this, HHI, DSME and SHI secured ~US$10.2bn, US$7.3bn and US$6.3bn new contracts last year, driven by orders for LNG carriers, vs Singapore yards where KOM and SMM clinched US$1.3bn and US$0.7bn respectively.

Shipbuilding contract backlog



Note: Apart from SMM (dated Sep-18), all the figures in the above chart are as at Dec-18.
Source: Companies

Shipbuilding revenue comparison (12-month trailing)



Source: Companies

Recommendations

In the event of merger speculation, **SMM (TP S$2.40; +50%) could re-rate** on anticipation of it being a privatisation / takeover target. In any case, we believe the current share price is a good entry point for SMM as: 1. We expect management tone to turn more positive as activity level, revenue and profitability are trending up; 2) optimism on new contracts for production platform in particular FPSOs for Brazil; 3) M&A angle.

Yangzijiang (TP S$1.82; +30%) is a prime beneciary of industry consolidation and shipbuilding recovery. Its move into LNG carrier space through partnership with Japanese yard Mitsui will pave their way into the new market. In addition, the stock offers a decent 3.5% dividend yield.

Global shipyards comparison

Company	Last Px (LC)	Market cap (US$m)	P/E FY18F	FY19F	P/B Current	ROE (%) FY18F	FY19F	Net D/E Current	Div Yld (%) Current
Singapore									
Keppel Corp*	6.1	8,212	11.0	9.5	1.0	8.3%	9.1%	0.47	4.8%
Sembcorp Industries	2.59	3,433	14.7	10.6	0.8	4.7%	6.2%	0.86	1.5%
Sembcorp Marine	1.6	2,482	nm	160.0	1.4	-4.1%	0.7%	1.11	0.6%
Yangzijiang	1.4	4,103	9.3	9.8	0.8	10.9%	9.7%	CASH	3.2%
China									
China Shipbuilding Industry Co (CSIC)	4.3	14,682	65.2	47.8	1.2	2.4%	3.1%	CASH	0.3%
Shanghai Zhenhua Heavy Industries	3.22	2,260	37.9	21.5	1.1	2.7%	4.8%	1.81	1.3%
China CSSC	12.39	2,548	49.2	41.0	1.1	2.8%	3.1%	0.27	nm
Korea									
Hyundai Heavy Industries	138,500	8,811	nm	25.0	0.8	0.5%	3.0%	0.09	nm
Samsung Heavy Industies	9,100	5,153	nm	44.4	0.8	-0.2%	1.8%	0.52	nm
Daewoo Shipbuilding	37,000	3,566	13.0	17.8	1.1	9.0%	5.5%	1.12	nm
		Average:	52.1	38.7	1.0	3.7%	4.7%	0.78	nm
		Median:	26.3	23.2	1.0	2.8%	4.0%	0.69	nm

** based on consensus*
Source: DBS Bank, Bloomberg Finance L.P.

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: 1 Feb 2019 09:29:47 (SGT)
Dissemination Date: 1 Feb 2019 09:55:56 (SGT)

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

Any assumptions made in this report that refers to commodities, are for the purposes of making forecasts for the company (or companies) mentioned herein. They are not to be construed as recommendations to trade in the physical commodity or in the futures contract relating to the commodity referred to in this report.

DBSVUSA, a US-registered broker-dealer, does not have its own investment banking or research department, has not participated in any public offering of securities as a manager or co-manager or in any other investment banking transaction in the past twelve months and does not engage in market-making.

ANALYST CERTIFICATION
The research analyst(s) primarily responsible for the content of this research report, in part or in whole, certifies that the views about the companies and their securities expressed in this report accurately reflect his/her personal views. The analyst(s) also certifies that no part of his/her compensation was, is, or will be, directly or indirectly, related to specific recommendations or views expressed in the report. The research analyst (s) primarily responsible for the content of this research report, in part or in whole, certifies that he or his associate[1] does not serve as an officer of the issuer or the new listing applicant (which includes in the case of a real estate investment trust, an officer of the management company of the real estate investment trust; and in the case of any other entity, an officer or its equivalent counterparty of the entity who is responsible for the management of the issuer or the new listing applicant) and the research analyst(s) primarily responsible for the content of this research report or his associate does not have financial interests[2] in relation to an issuer or a new listing applicant that the analyst reviews. DBS Group has procedures in place to eliminate, avoid and manage any potential conflicts of interests that may arise in connection with the production of research reports. The research analyst(s) responsible for this report operates as part of a separate and independent team to the investment banking function of the DBS Group and procedures are in place to ensure that confidential information held by either the research or investment banking function is handled appropriately. There is no direct link of DBS Group's compensation to any specific investment banking function of the DBS Group.

COMPANY-SPECIFIC / REGULATORY DISCLOSURES

1. DBS Bank Ltd, DBS HK, DBS Vickers Securities (Singapore) Pte Ltd (''DBSVS'') or their subsidiaries and/or other affiliates have proprietary positions in Keppel Corporation, Sembcorp Industries, Sembcorp Marine, Yangzijiang Shipbuilding recommended in this report as of 31 Dec 2018
2. Neither DBS Bank Ltd nor DBS HK market makes in equity securities of the issuer(s) or company(ies) mentioned in this Research Report.

Compensation for investment banking services:

3. DBS Bank Ltd, DBS HK, DBSVS their subsidiaries and/or other affiliates of DBSVUSA have received compensation, within the past 12 months for investment banking services from Keppel Corporation, Sembcorp Industries as of 31 Dec 2018
4. DBSVUSA does not have its own investment banking or research department, nor has it participated in any public offering of securities as a manager or co-manager or in any other investment banking transaction in the past twelve months. Any US persons wishing to obtain further information, including any clarification on disclosures in this disclaimer, or to effect a transaction in any security discussed in this document should contact DBSVUSA exclusively.

Directorship/trustee interests:

5. Danny Teoh Leong Kay, a member of DBS Group Holdings Board of Directors, is a Director of Keppel Corporation as of 31 Dec 2018.
6. Ang Teik Lim Eric, a member of DBS Group Research, is a Director, Member of Executive Resource & Compensation and Nominating Committee of Sembcorp Marine as of 07 Jan 2019.

Disclosure of previous investment recommendation produced:

7. DBS Bank Ltd, DBS Vickers Securities (Singapore) Pte Ltd (''DBSVS''), their subsidiaries and/or other affiliates may have published other investment recommendations in respect of the same securities / instruments recommended in this research report during the preceding 12 months. Please contact the primary analyst listed in the first page of this report to view previous investment recommendations published by DBS Bank Ltd, DBS Vickers Securities (Singapore) Pte Ltd (''DBSVS''), their subsidiaries and/or other affiliates in the preceding 12 months.

[1] An associate is defined as (i) the spouse, or any minor child (natural or adopted) or minor step-child, of the analyst; (ii) the trustee of a trust of which the analyst, his spouse, minor child (natural or adopted) or minor step-child, is a beneficiary or discretionary object; or (iii) another person accustomed or obliged to act in accordance with the directions or instructions of the analyst.

[2] Financial interest is defined as interests that are commonly known financial interest, such as investment in the securities in respect of an issuer or a new listing applicant, or financial accommodation arrangement between the issuer or the new listing applicant and the firm or analysis. This term does not include commercial lending conducted at arm's length, or investments in any collective investment scheme other than an issuer or new listing applicant notwithstanding the fact that the scheme has investments in securities in respect of an issuer or a new listing applicant.

RESTRICTIONS ON DISTRIBUTION

General	This report is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation.
Australia	This report is being distributed in Australia by DBS Bank Ltd, DBSVS or DBSV HK. DBS Bank Ltd holds Australian Financial Services Licence no. 475946. DBSVS and DBSV HK are exempted from the requirement to hold an Australian Financial Services Licence under the Corporation Act 2001 ("CA") in respect of financial services provided to the recipients. Both DBS Bank Ltd and DBSVS are regulated by the Monetary Authority of Singapore under the laws of Singapore, and DBSV HK is regulated by the Hong Kong Securities and Futures Commission under the laws of Hong Kong, which differ from Australian laws. Distribution of this report is intended only for "wholesale investors" within the meaning of the CA.
Hong Kong	This report has been prepared by a person(s) who is not licensed by the Hong Kong Securities and Futures Commission to carry on the regulated activity of advising on securities in Hong Kong pursuant to the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong). This report is being distributed in Hong Kong and is attributable to DBS Bank (Hong Kong) Limited, a registered institution registered with the Hong Kong Securities and Futures Commission to carry on the regulated activity of advising on securities pursuant to the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong). For any query regarding the materials herein, please contact Carol Wu (Reg No. AH8283) at dbsvhk@dbs.com
Indonesia	This report is being distributed in Indonesia by PT DBS Vickers Sekuritas Indonesia.
Malaysia	This report is distributed in Malaysia by AllianceDBS Research Sdn Bhd ("ADBSR"). Recipients of this report, received from ADBSR are to contact the undersigned at 603-2604 3333 in respect of any matters arising from or in connection with this report. In addition to the General Disclosure/Disclaimer found at the preceding page, recipients of this report are advised that ADBSR (the preparer of this report), its holding company Alliance Investment Bank Berhad, their respective connected and associated corporations, affiliates, their directors, officers, employees, agents and parties related or associated with any of them may have positions in, and may effect transactions in the securities mentioned herein and may also perform or seek to perform broking, investment banking/corporate advisory and other services for the subject companies. They may also have received compensation and/or seek to obtain compensation for broking, investment banking/corporate advisory and other services from the subject companies. Wong Ming Tek, Executive Director, ADBSR
Singapore	This report is distributed in Singapore by DBS Bank Ltd (Company Regn. No. 196800306E) or DBSVS (Company Regn No. 198600294G), both of which are Exempt Financial Advisers as defined in the Financial Advisers Act and regulated by the Monetary Authority of Singapore. DBS Bank Ltd and/or DBSVS, may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, DBS Bank Ltd accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact DBS Bank Ltd at 6327 2288 for matters arising from, or in connection with the report.
Thailand	This report is being distributed in Thailand by DBS Vickers Securities (Thailand) Co Ltd.
United Kingdom	This report is produced by DBS Bank Ltd which is regulated by the Monetary Authority of Singapore. This report is disseminated in the United Kingdom by DBS Vickers Securities (UK) Ltd, ("DBSVUK"). DBSVUK is authorised and regulated by the Financial Conduct Authority in the United Kingdom. In respect of the United Kingdom, this report is solely intended for the clients of DBSVUK, its respective connected and associated corporations and affiliates only and no part of this document may be (i) copied, photocopied or duplicated in any form or by any means or (ii) redistributed without the prior written consent of DBSVUK. This communication is directed at persons having professional experience in matters relating to investments. Any investment activity following from this communication will only be engaged in with such persons. Persons who do not have professional experience in matters relating to investments should not rely on this communication.

Dubai International Financial Centre	This research report is being distributed by DBS Bank Ltd., (DIFC Branch) having its office at units 608 - 610, 6th Floor, Gate Precinct Building 5, PO Box 506538, DIFC, Dubai, United Arab Emirates. DBS Bank Ltd., (DIFC Branch) is regulated by The Dubai Financial Services Authority. This research report is intended only for professional clients (as defined in the DFSA rulebook) and no other person may act upon it.
United Arab Emirates	This report is provided by DBS Bank Ltd (Company Regn. No. 196800306E) which is an Exempt Financial Adviser as defined in the Financial Advisers Act and regulated by the Monetary Authority of Singapore. This report is for information purposes only and should not be relied upon or acted on by the recipient or considered as a solicitation or inducement to buy or sell any financial product. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situation, or needs of individual clients. You should contact your relationship manager or investment adviser if you need advice on the merits of buying, selling or holding a particular investment. You should note that the information in this report may be out of date and it is not represented or warranted to be accurate, timely or complete. This report or any portion thereof may not be reprinted, sold or redistributed without our written consent.
United States	This report was prepared by DBS Bank Ltd. DBSVUSA did not participate in its preparation. The research analyst(s) named on this report are not registered as research analysts with FINRA and are not associated persons of DBSVUSA. The research analyst(s) are not subject to FINRA Rule 2241 restrictions on analyst compensation, communications with a subject company, public appearances and trading securities held by a research analyst. This report is being distributed in the United States by DBSVUSA, which accepts responsibility for its contents. This report may only be distributed to Major U.S. Institutional Investors (as defined in SEC Rule 15a-6) and to such other institutional investors and qualified persons as DBSVUSA may authorize. Any U.S. person receiving this report who wishes to effect transactions in any securities referred to herein should contact DBSVUSA directly and not its affiliate.
Other jurisdictions	In any other jurisdictions, except if otherwise restricted by laws or regulations, this report is intended only for qualified, professional, institutional or sophisticated investors as defined in the laws and regulations of such jurisdictions.

DBS Regional Research Offices

HONG KONG
DBS (Hong Kong) Ltd
Contact: Carol Wu
13th Floor One Island East,
18 Westlands Road,
Quarry Bay, Hong Kong
Tel: 852 3668 4181
Fax: 852 2521 1812
e-mail: dbsvhk@dbs.com

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

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

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

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