

Singapore Company Guide

Sembcorp Industries

Version 23 | Bloomberg: SCI SP | Reuters: SCIL.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

12 Sep 2019

BUY

Last Traded Price (11 Sep 2019): S\$2.21 (STI : 3,204.52)

Price Target 12-mth: S\$3.20 (45% upside)

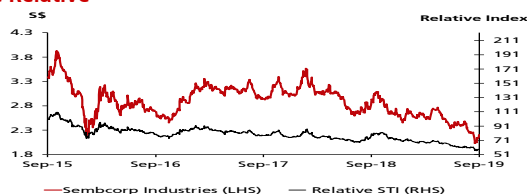
Analyst

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What's New

- Management reassures investors with strategies to augment balance sheet and improve ROE during NDR
- Energy and Urban solutions see growth in emerging markets
- Over-penalised for marine weakness; SCI's valuation now at 0.5x P/BV despite delivering 5-6% ROE
- Reiterate BUY; TP S\$3.20

Price Relative



Forecasts and Valuation

FY Dec (\$m)	2017A	2018A	2019F	2020F
Revenue	9,026	11,689	9,714	9,722
EBITDA	1,712	1,379	1,534	1,825
Pre-tax Profit	611	420	495	750
Net Profit	383	347	357	425
Net Pft (Pre Ex.)	504	345	357	425
Net Pft Gth (Pre-ex) (%)	23.8	(31.5)	3.3	19.1
EPS (S cts)	21.4	19.4	20.0	23.8
EPS Pre Ex. (S cts)	28.2	19.3	20.0	23.8
EPS Gth Pre Ex (%)	24	(31)	3	19
Diluted EPS (S cts)	21.3	19.3	19.8	23.6
Net DPS (S cts)	5.00	4.00	4.99	5.94
BV Per Share (S cts)	388	380	396	414
PE (X)	10.3	11.4	11.1	9.3
PE Pre Ex. (X)	7.8	11.4	11.1	9.3
P/Cash Flow (X)	6.1	5.3	6.3	3.0
EV/EBITDA (X)	7.2	10.1	9.4	7.9
Net Div Yield (%)	2.3	1.8	2.3	2.7
P/Book Value (X)	0.6	0.6	0.6	0.5
Net Debt/Equity (X)	0.9	1.1	1.1	1.1
ROAE (%)	5.6	5.1	5.1	5.9
Earnings Rev (%):			-	-
Consensus EPS (S cts):			21.9	26.4
Other Broker Recs:		B: 10	S: 1	H: 3

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

Turning Greener

Maintain BUY; TP S\$ 3.20. Sembcorp Industries (SCI) offers a unique value proposition as a defensive utilities business, and as a proxy to ride the cyclical O&M recovery. Stripping out Marine's current valuation, Energy business is deeply undervalued at 0.5x P/BV and 5x PE against 6-7% ROE. In fact, the stock is trading close to our ~\$2 fair value of SCI's businesses excluding Marine, implying its marine business comes free.

Emerging markets are the long-term growth engines. SCI's India operations swung from a loss of S\$58m in 2017 to profit of S\$47m in 2018, and the positive trend should continue. The power market in India is recovering with current peak surplus expected to reverse by FY20, according to independent research house CRISIL, driving up tariffs. Besides India, SCI has also made forays into other emerging markets – Bangladesh, Vietnam and Myanmar.

Where we differ: We believe in the long-term growth prospects of SCI's Energy arm, which has expanded its global footprint into key emerging markets – India, Bangladesh, Vietnam, and Myanmar. 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. We believe a spin-off of its marine arm could re-rate SCI's undervalued utilities business that is being overshadowed by the cyclical marine business.

Valuation:

We derive our fair value for SCI based on the sum of its different parts, with a 10% conglomerate discount to the RNAV, to arrive at a TP of S\$ 3.20. This represents 0.8x P/BV.

Key Risks to Our View:

Key risks to earnings are further delays in marine contract wins, deterioration of Singapore's power spark spreads, and execution hiccups at its Indian power plants.

At A Glance

Issued Capital (m shrs)	1,787
Mkt. Cap (S\$m/US\$m)	3,950 / 2,863
Major Shareholders (%)	
Temasek Holdings Pte Ltd	49.5
Free Float (%)	50.5
3m Avg. Daily Val (US\$m)	6.5
ICB Industry : Oil & Gas / Oil Equipment, Services & Dist	
Bloomberg ESG disclosure score (2017)^	39.3
- Environmental / Social / Governance	28.7 / 43.9 / 58.9

[^ refer to back page for more information](#)



Live more, Bank less

WHAT'S NEW

Post Non-Deal Roadshow takeaways

During our recent NDR with SCI in Toronto, Chicago and New York, we sensed that investors generally see value emerging for SCI, though they are hoping to have better visibility on re-rating catalysts. Key questions revolved on its balance sheet augmentation, ROE enhancement, strategy for India, Energy growth strategy, and marine recovery.

Set on recovery path. Both Energy and Marine (through Sembcorp Marine, SMM) businesses have probably seen their worst and are set on a recovery path. Management

previously guided in their Strategic Review released in Feb-2018 that they aim to improve ROE from current **mid-single digit to double-digit over the next 5-years** through improvements in both Marine and Energy segments.

ROE recovery is indeed a critical factor for SCI's re-rating in our view. This can be achieved through divestment of noncore/non-performing assets, and earnings growth. Two key drivers are SMM's and India's turnaround.

SCI's valuation is highly correlated to ROE



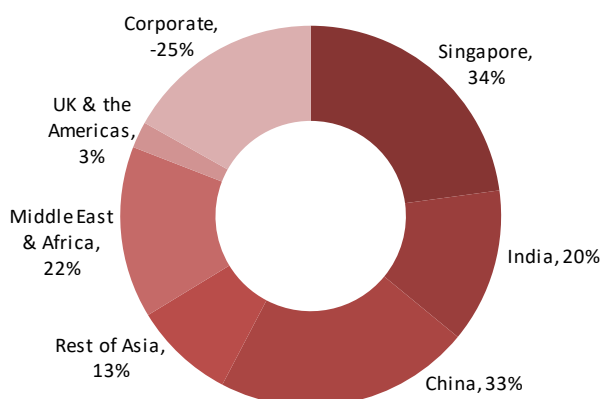
Source: Company, DBS Bank, Bloomberg Finance L.P.

Fast growing Energy demand in emerging markets. Singapore remains the largest earnings contributor to Energy's bottomline. The oversupply situation should ease by 2023 as a few plants are old - about 2000MW could come off by then, eliminating the excess supply. In India, recovering trend is expected to continue as well, lifting current low single digit ROE.

Energy demand and economic well-being typically go hand-in-hand. **In terms of GDP growth**, low single digit growth is expected in more developed countries like Singapore and Middle East; mid-single digit growth in China while high single digit growth could be expected in Rest of Asia or emerging markets. In recent years, SCI has made forays into other emerging markets besides India – Bangladesh, Vietnam and Myanmar – and this should underpin the longer-term growth prospects of its Energy segment.

Energy Profit by Geography

Energy 1H19 Net Profit by Geography - S\$98.3m



Source: Company, DBS Bank

Focus on improving cash flows and stable returns.

Acknowledging the current less than ideal net gearing of >1x, SCI has placed much emphasis on improving cash flow and paring down debt.

SCI has freed up ~S\$300m of capital through divestment of non-core assets (such as slow cash flow generation assets, coal-fired power plants etc), on track to meet its S\$500m (excluding India IPO plan) target by 2020.

Management plans to **divest or pare down stake in some assets in India and China** while **reinvesting in Singapore and UK**. India's coal-fired power plants generate lower returns yet have longer receivables. SCI's PPA was with the state government, which generally pays slower than Central government. First choice will be an IPO, which SCI had attempted a year back but held back awaiting better market conditions. The cash proceeds will be utilised to fund renewables expansion in India, where SCI has emerged to be one of the largest players there.

In China, given the tight capital controls, SCI plans to recycle capital and focus more on environmental and renewable projects in China.

In UK, while management remains optimistic on the longer-term prospect, it will likely wait for better clarity on Brexit uncertainties before concluding any major growth plan.

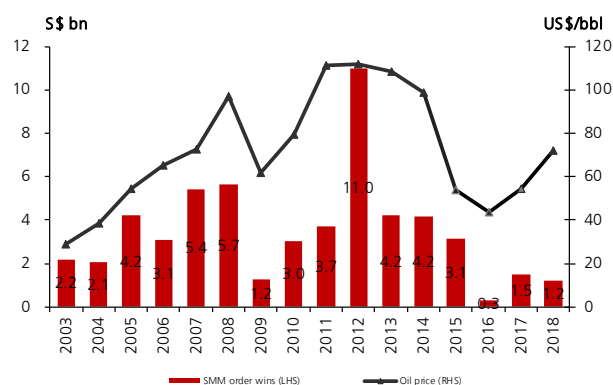
Turning greener for sustainability. With the push for sustainability, renewable energy is expected to grow from 30% of capacity to target of 50% gradually by 2022. While renewable energy typically fetches lower return of mid-to-high single digit as compared to low teens for conventional energy, income could be more predictable with long-term PPAs.

Beneficiary of trade war with more Petrochemical and industrial investments in SEA. For instance, ExxonMobil announced in early April that it is undertaking a multi-billion-dollar expansion of its **Jurong Island integrated manufacturing complex** in Singapore. Gas and engineering giant Linde has signed a long-term agreement with ExxonMobil Asia Pacific in June, which will see it investing US\$1.4bn to expand its existing gasification complex at Jurong Island. These will drive demand for SCI's one-stop centralised utilities solutions there.

On the back of US-China trade war, there has been trade diversions and inflow of foreign investment into SEA as companies started to shift their **manufacturing activities** to this region. This bodes well for SCI's Urban segment - land sales growth in Vietnam.

Marine recovery takes time. Order win is the critical factor to watch for SMM as orderbook is running low at ~S\$2.1bn (approx 1x revenue coverage) and YTD contract wins are lagging at ~S\$575m (vs street expectations of S\$2-3bn at the start of the year). Offshore and Marine sector continues to improve, albeit gradual, especially for the offshore production segment. SMM has been actively responding to an increasing pipeline of tenders and enquiries for production and gas-related projects and management remains hopeful on securing new orders in the foreseeable quarters. But, competition remains intense and order intake could increase at a moderated pace.

Sembcorp Marine annual order wins



Source: Company, DBS Bank

CRITICAL DATA POINTS TO WATCH

Critical Factors

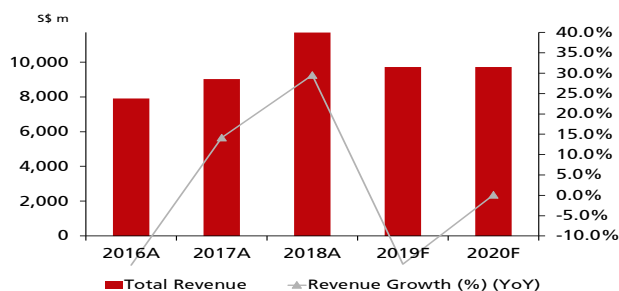
Earnings recovery. We expect earnings recovery for both Energy and Marine segments. For Energy in India, Sembcorp Energy India Limited (SEIL) - SCI's first Indian power plant (SEIL Project 1) - is starting to contribute more steadily at ~\$15m a quarter to the bottom line. Meanwhile, losses at its second plant (SEIL Project 2) should narrow to a near-breakeven level after its refinancing exercise last year, load factor & tariff improvements, as well as commencement of long-term PPA in Bangladesh in February 2019 (19% of capacity) and in Andhra Pradesh in 2020 (38% of capacity). For Marine, we expect a turnaround driven by stronger contract wins to translate into higher yard activities next year.

Utilities in emerging markets remain the growth engine. SEIL operates 3,567MW of power capacity comprising 2,640MW of thermal power and 927MW of renewable capacity. Management targets to grow renewable capacity in India by 300-500MW p.a. Besides India, SCI has also made forays into other emerging markets – Bangladesh, Vietnam and Myanmar – and this should underpin the longer-term growth prospects of its Energy segment beyond 2019. Long-term PPAs have been secured for both Myanmar's 230MW gas-fired Myingyan Independent Power Producer (IPP) and Bangladesh's 427MW gas-fired Sirajganj Unit 4 which were completed in 1H19.

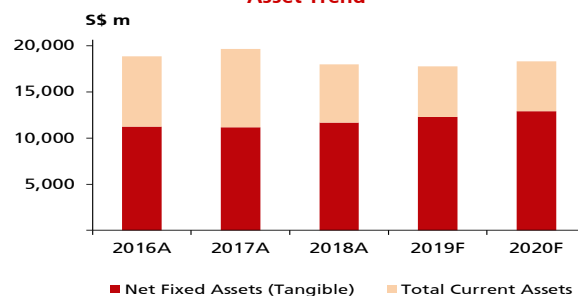
Marine business (SMM) earnings are orderbook-driven. We expect new orders to recover in FY20 from the dismal ~\$300m in FY16, \$1bn in FY17 and \$1.2n in 2018 to \$1.5bn in 2019 driven by the new Gravitfloat modularised LNG terminal solutions and FPSO projects. SMM's orderbook stood at \$5.8bn as at March 2019, with c.\$2.6bn from the drillship projects with Sete Brasil. This translates into a book-to-bill ratio of over 1x based on the existing delivery schedule.

Urban Development business provides growth opportunities. Urban Development accounts for c.20% of SCI's bottom line on average but its 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 504 ha of net orderbook across China, Indonesia and Vietnam.

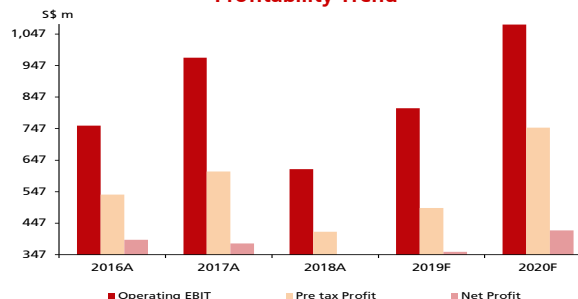
Sales Trend



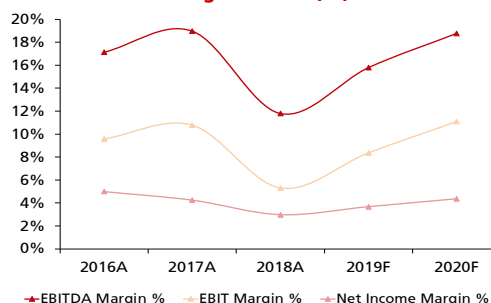
Asset Trend



Profitability Trend



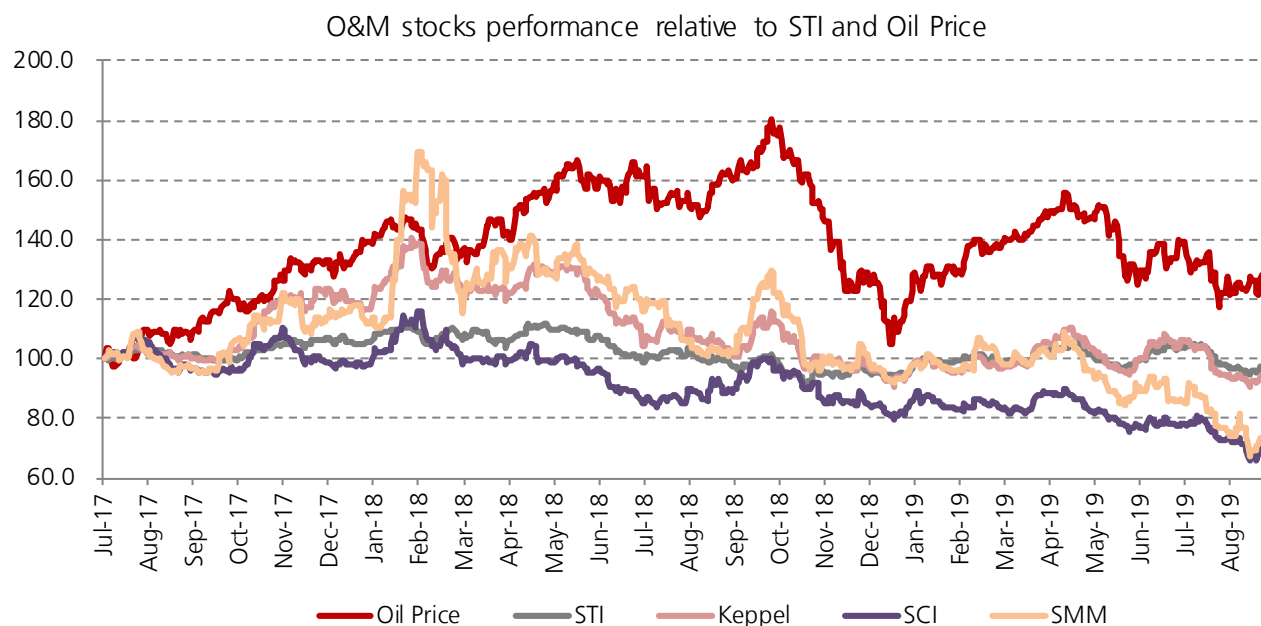
Margin Trends (%)



Source: Company, DBS Bank

Appendix 1: A look at Company's listed history – what drives its share price?

Sembcorp Industries's Share Price has underperformed Oil Price and STI



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

Sembcorp Industries's P/B vs ROE; turnaround of SEIL Project 2 and Marine are key earnings and ROE driver



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

Balance Sheet:

SCI's net gearing stabilised at 1.1x as at June 2019. SCI's current gearing position is in stark contrast to its net cash position in 2013 due to increasing leverage at SMM and expansion into India. 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. Orders for production-related facilities are expected to flow through.

Marine order wins and Urban Development land sales bode 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 its share price.

Widening spark spreads at India and Singapore power plants.

Signs of positive and widening spark spreads in India and Singapore would alleviate a key concern of investors.

Key Risks:

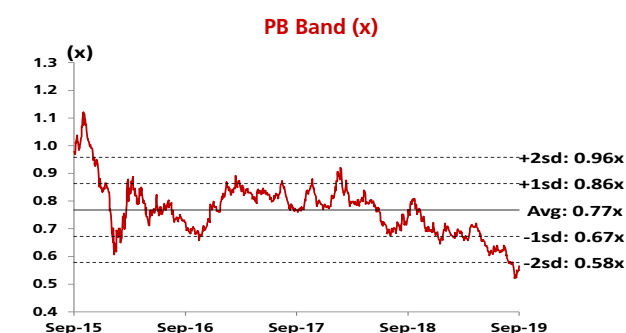
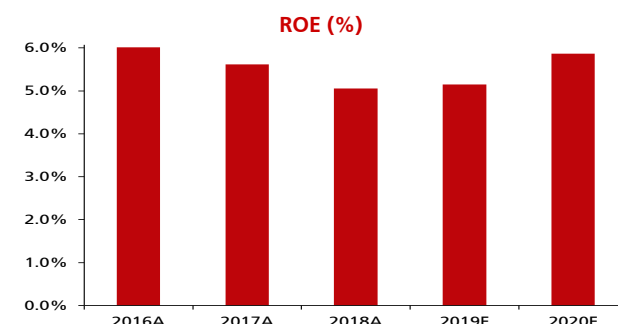
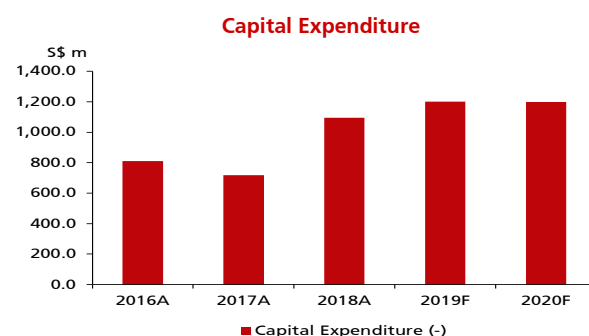
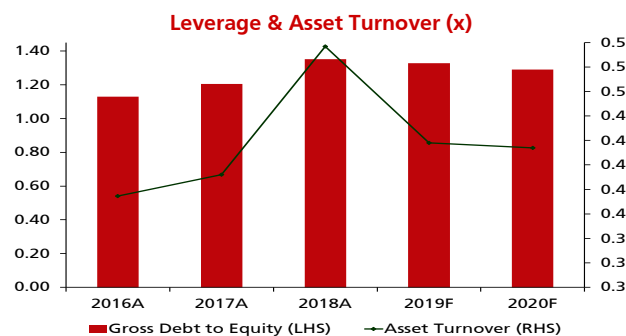
Execution of Indian power plants. The availability of coal supply and tariff fluctuation for SCI's power plants in India are concerns. We find comfort that the SEIL Project 1 is up and running, with 86% of capacity committed on long-term PPAs and operating using both domestic and imported coal. SEIL Project 2 has also shown signs of recovery with ~57% of capacity under long-term PPAs in place for 2019.

Environment, Social, Governance:

Sembcorp has long held a strong commitment to sustainability by enabling a low-carbon and circular economy, empowering the company's people and communities and embedding responsible business practices. In 2018, Sembcorp was once again selected as an index component of both the Dow Jones Sustainability Asia Pacific Index and the SGX Sustainability Leaders Index.

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 over 11,000MW of gross power capacity and over 9m 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 [SMM]) as well as an established brand name in urban development (comprising industrial parks as well as business, commercial and residential space) in Vietnam, China and Indonesia.



Source: Company, DBS Bank

Key Assumptions

FY Dec	2016A	2017A	2018A	2019F	2020F
Marine contract wins	300	1,000	1,200	1,500	4,000

Segmental Breakdown

FY Dec	2016A	2017A	2018A	2019F	2020F
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Revenues (\$m)

Utilities	4,111	5,697	6,536	6,629	6,794
Marine	3,544	3,035	4,888	2,871	2,754
Industrial Parks	7.05	7.76	5.00	6.16	7.39
Other Businesses and	245	280	260	208	166

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Total	7,907	9,020	11,689	9,714	9,722
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Net Profit before EI

Utilities	348	140	312	350	359
Marine	48.3	6.83	(48.0)	(32.6)	16.4
Industrial Parks	33.3	83.2	86.0	68.8	69.6
Other Businesses and	(34.7)	0.68	(3.0)	(30.0)	(20.0)

Total	395	231	347	357	425
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Net Profit before EI

Utilities	8.5	2.5	4.8	5.3	5.3
Marine	1.4	0.2	(1.0)	(1.1)	0.6
Industrial Parks	472.2	1,072.8	1,720.0	1,116.7	941.7
Other Businesses and	(14.2)	0.2	(1.2)	(14.4)	(12.0)

Total	5.0	2.6	3.0	3.7	4.4
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Income Statement (\$m)

FY Dec	2016A	2017A	2018A	2019F	2020F
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Revenue	7,907	9,026	11,689	9,714	9,722
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Cost of Goods Sold	(6,802)	(7,735)	(10,769)	(8,451)	(8,170)
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Gross Profit	1,105	1,291	920	1,263	1,552
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Other Opng (Exp)/Inc	(349)	(320)	(302)	(451)	(475)
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Operating Profit	756	972	618	812	1,077
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Other Non Opg (Exp)/Inc	39.6	30.0	40.0	(7.8)	(7.8)
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Associates & JV Inc	125	164	174	157	153
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Net Interest (Exp)/Inc	(372)	(434)	(414)	(466)	(473)
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Exceptional Gain/(Loss)	(12.1)	(121)	1.79	0.0	0.0
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Pre-tax Profit	537	611	420	495	750
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Tax	(100)	(118)	(88.0)	(160)	(315)
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Minority Interest	(42.3)	(110)	15.0	21.2	(10.7)
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Preference Dividend	0.0	0.0	0.0	0.0	0.0
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Net Profit	395	383	347	357	425
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Net Profit before Except.	407	504	345	357	425
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EBITDA	1,355	1,712	1,379	1,534	1,825
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Growth

Revenue Gth (%)	(17.2)	14.2	29.5	(16.9)	0.1
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EBITDA Gth (%)	129.6	26.4	(19.5)	11.3	18.9
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Opg Profit Gth (%)	(446.5)	28.5	(36.4)	31.4	32.6
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Net Profit Gth (Pre-ex) (%)	230.1	23.8	(31.5)	3.3	19.1
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Margins & Ratio

Gross Margins (%)	14.0	14.3	7.9	13.0	16.0
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Opg Profit Margin (%)	9.6	10.8	5.3	8.4	11.1
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Net Profit Margin (%)	5.0	4.2	3.0	3.7	4.4
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ROAE (%)	6.0	5.6	5.1	5.1	5.9
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ROA (%)	1.9	1.7	1.5	1.5	1.8
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ROCE (%)	3.6	4.2	2.5	2.8	3.1
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Div Payout Ratio (%)	36.2	23.3	20.6	25.0	25.0
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Net Interest Cover (x)	2.0	2.2	1.5	1.7	2.3
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Source: Company, DBS Bank

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

FY Dec	2Q2018	3Q2018	4Q2018	1Q2019	2Q2019
Revenue	3,344	3,022	2,566	2,480	2,372
Cost of Goods Sold	(3,155)	(2,780)	(2,338)	(2,213)	(2,107)
Gross Profit	189	242	228	267	265
Other Oper. (Exp)/Inc	(63.7)	(52.2)	(95.9)	(89.0)	(87.0)
Operating Profit	126	190	132	178	178
Other Non Opg (Exp)/Inc	0.0	0.0	40.0	0.0	0.0
Associates & JV Inc	55.6	36.9	39.6	45.0	54.0
Net Interest (Exp)/Inc	(104)	(97.0)	(116)	(108)	(115)
Exceptional Gain/(Loss)	11.0	(10.2)	1.00	0.0	0.0
Pre-tax Profit	88.6	120	95.9	115	117
Tax	(24.0)	(39.4)	12.9	(18.0)	(15.0)
Minority Interest	17.3	2.25	(2.7)	(4.0)	(4.0)
Net Profit	81.9	82.3	106	93.0	98.0
Net profit bef Except.	70.9	92.6	105	93.0	98.0
EBITDA	181	227	211	223	232

Growth

Revenue Gth (%)	21.3	(9.6)	(15.1)	(3.3)	(4.4)
EBITDA Gth (%)	(15.0)	25.2	(6.8)	5.5	4.0
Opg Profit Gth (%)	(26.7)	51.2	(30.6)	35.2	0.0
Net Profit Gth (Pre-ex) (%)	(7.5)	30.5	13.6	(11.5)	5.4

Margins

Gross Margins (%)	5.7	8.0	8.9	10.8	11.2
Opg Profit Margins (%)	3.8	6.3	5.1	7.2	7.5
Net Profit Margins (%)	2.4	2.7	4.1	3.8	4.1

Balance Sheet (\$\$m)

FY Dec	2016A	2017A	2018A	2019F	2020F
Net Fixed Assets	11,226	11,158	11,672	12,298	12,895
Invts in Associates & JVs	1,746	1,765	1,741	1,828	1,911
Other LT Assets	1,694	2,330	3,584	3,584	3,584
Cash & ST Invts	1,883	2,687	1,925	1,500	1,743
Inventory	3,466	3,548	1,864	1,943	1,944
Debtors	1,958	2,094	2,289	1,766	1,496
Other Current Assets	317	163	246	246	246
Total Assets	22,290	23,745	23,321	23,165	23,819
ST Debt	2,126	1,572	1,862	1,862	1,862
Creditor	3,398	3,340	2,968	2,467	2,468
Other Current Liab	492	1,421	746	678	833
LT Debt	7,096	8,275	8,870	9,020	9,170
Other LT Liabilities	1,016	963	937	937	937
Shareholder's Equity	6,701	6,944	6,788	7,073	7,408
Minority Interests	1,461	1,230	1,150	1,129	1,139
Total Cap. & Liab.	22,290	23,745	23,321	23,165	23,818
Non-Cash Wkg. Capital	1,852	1,044	685	811	385
Net Cash/(Debt)	(7,339)	(7,160)	(8,807)	(9,382)	(9,289)
Debtors Turn (avg days)	81.4	81.9	68.4	76.2	61.2
Creditors Turn (avg days)	194.5	171.1	112.6	125.9	119.0
Inventory Turn (avg days)	220.6	178.1	96.6	88.2	93.7
Asset Turnover (x)	0.4	0.4	0.5	0.4	0.4
Current Ratio (x)	1.3	1.3	1.1	1.1	1.1
Quick Ratio (x)	0.6	0.8	0.8	0.7	0.6
Net Debt/Equity (X)	0.9	0.9	1.1	1.1	1.1
Net Debt/Equity ex MI (X)	1.1	1.0	1.3	1.3	1.3
Capex to Debt (%)	8.8	7.3	10.2	11.0	10.9
Z-Score (X)	1.1	1.1	1.1	1.1	1.1

Source: Company, DBS Bank

Cash Flow Statement (\$m)

FY Dec	2016A	2017A	2018A	2019F	2020F
Pre-Tax Profit	537	611	420	495	750
Dep. & Amort.	454	571	595	574	602
Tax Paid	(85.8)	(69.9)	(122)	(153)	(160)
Assoc. & JV Inc/(loss)	(125)	(164)	(174)	(157)	(153)
Chg in Wkg.Cap.	(395)	(791)	(389)	(133)	271
Other Operating CF	487	494	409	0.0	0.0
Net Operating CF	872	651	739	627	1,311
Capital Exp.(net)	(810)	(718)	(1,096)	(1,200)	(1,199)
Other Invt.(net)	0.0	206	(380)	0.0	0.0
Invt in Assoc. & JV	(60.9)	37.8	0.0	0.0	0.0
Div from Assoc & JV	122	307	70.0	70.0	70.0
Other Investing CF	(51.6)	75.8	189	0.0	0.0
Net Investing CF	(801)	(92.0)	(1,217)	(1,130)	(1,129)
Div Paid	(225)	(162)	(100.0)	(71.5)	(89.2)
Chg in Gross Debt	1,107	779	854	150	150
Capital Issues	0.0	0.0	0.0	0.0	0.0
Other Financing CF	(668)	(363)	(1,013)	0.0	0.0
Net Financing CF	214	253	(259)	78.5	60.8
Currency Adjustments	(35.0)	(8.0)	(25.0)	0.0	0.0
Chg in Cash	250	804	(762)	(425)	242
Opg CFPS (S cts)	70.9	80.7	63.1	42.5	58.1
Free CFPS (S cts)	3.46	(3.8)	(20.0)	(32.1)	6.25

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:	01 Oct 18	3.07	3.90	BUY
2:	05 Oct 18	2.95	3.90	BUY
3:	05 Nov 18	2.69	3.70	BUY
4:	07 Nov 18	2.67	3.70	BUY
5:	10 Dec 18	2.60	3.70	BUY
6:	16 Jan 19	2.68	3.70	BUY
7:	01 Feb 19	2.58	3.70	BUY
8:	22 Feb 19	2.67	3.90	BUY
9:	27 Feb 19	2.63	3.90	BUY
10:	08 Apr 19	2.75	3.90	BUY
11:	12 Apr 19	2.73	3.90	BUY
12:	25 Apr 19	2.72	3.90	BUY
13:	16 May 19	2.55	3.90	BUY
14:	24 Jun 19	2.41	3.90	BUY
15:	03 Jul 19	2.41	3.90	BUY
16:	16 Aug 19	2.23	3.20	BUY

Source: DBS Bank

Analyst: Pei Hwa HO

^ Bloomberg ESG Disclosure Scores rate companies annually based on their disclosure of quantitative and policy-related ESG data. It is based on a scoring scale of 0-100, and calculated using a subset of more than 100 raw data points it collects on ESG. It is designed to measure the robustness of companies' disclosure of ESG information in their reporting/the public domain. Based on Bloomberg disclosures, as of 25 Jan 2019, the global ESG disclosure average score is 24.92 and 22.14, 28.26, 49.97 for Environmental, Social and Governance, respectively.

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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)

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 share price catalysts within this time frame)

*Share price appreciation + dividends

Completed Date: 12 Sep 2019 08:47:54 (SGT)

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