

Keppel Corporation 2Q & 1H2019 Results Briefing

Transcript of the Question & Answer Session

18 July 2019, 5.30pm, Keppel Leadership Institute

LCH	Loh Chin Hua, CEO of Keppel Corporation
CHC	Chan Hon Chew, CFO of Keppel Corporation
OTG	Ong Tiong Guan, CEO of Keppel Infrastructure
CT	Christina Tan, CEO of Keppel Capital
CO	Chris Ong, CEO of Keppel Offshore & Marine
TSY	Tan Swee Yiow, CEO of Keppel Land
TP	Thomas Pang, CEO of Keppel T&T
MSM	Manjot Singh Mann, CEO of M1

Questions from Mr Gerald Wong, Credit Suisse

I've got two questions. Firstly, on the O&M division, last quarter you spoke about hiring 1,800 full-time staff over the course of 2019. How is that coming along? Are there any changes in the plans given the uncertain economic outlook? The second question is on property. Given the strong take-up for the project launches that you've seen in Nanjing and Tianjin, what are the plans for the land sales in Tianjin Eco-City in the second half of this year?

LCH: For the first question, I will ask Chris Ong to address that.

CO: So far there's no change in plan. Based on the projects that were secured, we are continuing our plan to boost our headcount in order to execute our projects well. So far, in 2Q 2019, KOM hired 1,190 new personnel in the Group.

LCH: Actually, in Singapore we are trying very hard to hire more people. It's quite challenging, and we're hoping to get more people. We are executing an orderbook business, and even though, as I said at the beginning of my remarks, the external environment has become more sombre, we do have an orderbook to execute, and the workflow is expected to pick up at KOM.

LCH: On the property question, I think your question was related to the Tianjin Eco-City's launch of sites. We are always looking for opportunities to do that. The conditions for land sales in China have actually improved. Although we only sold one site, I think that was at the end of last year, we are preparing for sale in the second half. The outlook looks quite decent. We will try to take advantage of the more positive sentiments for land sales.

Questions from Mr Jason Yeo, Goldman Sachs Singapore

Good evening. I've got two questions. The first question is on the O&M business. Your orderbook is improving but what do you think about the trajectory of the profitability of the business, because sequentially we haven't seen a pickup yet? The second question is on the Singapore property business. Do you see an opportunity to redevelop Keppel and GE Towers given the CBD incentive scheme?

LCH: Can I ask Swee Yiow to address the second question?

TSY: Sure, Keppel Towers falls under the CBD incentive scheme, under the government's draft masterplan. Essentially, they are encouraging the conversion of more commercial/office use into mixed-use and residential. So, there are different parameters, and we are evaluating the options to see how we can maximise the development's potential.

LCH: Thank you. Now, on your question on O&M, we are very pleased to see that for the first half, KOM has made a profit as compared to the first half of last year. As I've said before, we were looking for KOM to break-even first. The orderbook has also been replenished. It is at the highest level since 2016, when we removed the Sete contracts from our orderbook. We're quite happy with where it's going, but obviously, as we said before, this is not going to be a V-shaped recovery. More importantly, if you look at the orderbook, for the new orders that were won in the first half, a significant portion of the new orders reflected the pivot that we took, not just looking at oil, but also looking at renewables, to the gas strategy, as well as to the non-oil and gas sector. So, the trend is encouraging, but in terms of profitability, we do not see a V-shaped recovery.

Questions from Ms Cheryl Lee, UBS Singapore

I have a few questions. Firstly, with regards to the investment division, the gains fell from \$83 million in the first quarter to \$39 million this half year. Why is that? That's a change of \$44 million. And also, there were additional M1 costs, related to the acquisition in the first quarter as well as the second quarter. Is this over, or can we expect more of such charges? And then, on the balance sheet, debt has increased on a quarter-on-quarter basis. Could you perhaps give us some guidance on your working capital needs, I suppose for offshore and marine, and property as well, to help us understand whether gearing might rise through to the end of the year?

CHC: I think your question is on the investment net profit quarter-on-quarter. For the first quarter, we had the benefit of fair value gain on our previously held interest in M1. You can actually see that in the SGXNET, the pre-tax profit is about \$158 million. With that, the investment division's profits were boosted. In the second quarter, we don't have the benefit of that, so as a result, quarter-on-quarter, it has come down. You also asked about the M1 cost in the first quarter as well as the second quarter. They are made up of largely three components. In the first quarter, there were one-off costs related to the acquisition of M1. In the second quarter, there wasn't that item, but then of course, we have the interest cost and amortisation cost. The amortisation cost relates to amortisation of intangibles, because upon acquisition, you need to do a purchase price allocation, where some intangible assets need to be amortised, and as a result there is an amortisation cost that is recurring. So the interest and the amortisation are recurring, but not the one-off professional fees.

For the balance sheet and working capital, as the O&M business recovers, of course there will be increase in the working capital demands, especially for some of the projects like the Awilco rig that was based on back-ended payment, so that is the working capital requirement. Likewise, if you look at the property business, as we progress with the developments, there will be increase in working capital, as well as in terms of land acquisitions – that is also reflected as part of the working capital. So I think it's to be expected that as the O&M business recovers, and as we continue to buy land, there will be increase in working capital requirements. But they will be partly offset - for example, if you

have en-bloc sales, it will offset the working capital increase. We do not give projections on such working capital requirements.

LCH: If I can just add to the last point on gearing, as we sell properties that are overseas, we don't recognise the revenue until the property is sold and completed. But quite often in these markets, we do collect the sales proceeds progressively as we build. So this sales collection, or the revenue that we collect on the sale price, can help to fund some of our project costs. So it's not just about en-bloc sales, it's about sales of the units as part of our property trading business. We have said before that we are watching our gearing very closely. We do not expect our gearing to go above 1x. The other thing about the property division is that we have set ourselves a target of 12% ROE in the medium to long term, so that means we will have to turn our assets more. So besides trading, we can also look for opportunities for divestments or for en-bloc sales.

Questions from Ms Lim Siew Khee, CIMB Singapore

In the Investments division, what is the negative movement quarter-on-quarter of S\$44m in 'Others' under investment in 2Q19? In the Offshore & Marine division, is this as good as it gets for the EBIT margin?

LCH: I think for the second question, we hope that it will improve. I think our top line is still not where we would like to see it and we want to see that improve. Of course, with better quality projects and as the market recovers, we hope to see this margin improve. Hon Chew, can I ask you to answer the first question?

CHC: I think the first question is the same question which Cheryl had asked. So quarter-on-quarter, the main reason for the movement is the M1 one-off re-measurement gain that I talked about earlier.

Question from Mr Adrian Loh, UOB Kay Hian

My question relates to the O&M sector. In particular, just wanted to get your thoughts about regional competition and how Keppel is thinking about facing up to it, because we are seeing the Korean yards potentially merging, Hyundai Heavy and DSME, and also the Chinese shipyards are making moves to merge. How does Keppel think about this potentially increased level of competition in the region for some of the same jobs that you might be competing for?

CO: The landscape itself has always been competitive. We know that some of the competitors are merging and all of us are going for mainly the same pool of jobs. But we differentiate ourselves, as is evident from the contract wins - we stay close to the customer. Being a solutions provider, we sit down with them to see how in this challenging environment for them, we are able to give value-add services. On top of that, we also look at our cost of operation. We train our people even during the challenging times to make sure that they are all geared up for new technologies like in the renewables area. In these different ways, from looking at cost, looking at capabilities and looking at solutions that we are able to provide to our customers, we try to stay ahead of the curve. On top of that, for operations within the yard, in terms of efficiency, we also spend a lot of time looking at how digitalisation can help with the efficiency of our operations. So there are different measures on how we are gearing up for competition.

Question from Mr Andrew, a retail investor in Singapore

Keppel's ROE seems to be going down since 2014. In the property sector, the sale in Singapore is not doing well amidst the oversupply and in the offshore sector, the outlook seems to be dampened despite the oil price stabilisation. What is the company's strategy?

LCH: I think that is a very good question, Andrew, thank you for that, as you have been following - I assume you have been following - the development of our strategy over the past few years. In 2014, when our ROE was at 18.8%, that was also the start of the decline in oil price. For those of you who remember a bit further back, KOM used to be a very strong contributor to the Group and we have had years also where the ROE was even higher than 18.8%. But in recent times, of course, with the correction in oil price, I think KOM has undergone a restructuring and in the last few years, KOM has not been contributing to the Group's profits and returns. But we are still very positive that in the medium to long term, KOM will provide good returns for the Group.

Now in the meantime, reflecting that we are a multi-business Group, we have other businesses propping us up, particularly in the last few years from property. We also have businesses that have been matured over the decades – a decade or two decades - such as Keppel Infrastructure. It is producing in the first half of this year an ROE of close to 20%. Keppel Capital's ROE is also around 20% and of course, we also have recently acquired M1, whose ROE I believe is around 20%. So as a Group, we do expect to see our ROE in the medium to long term improve to about 15%. That is our target. That would require, of course, all our engines to be firing. We believe that when that day comes, and we have contributions from all parts of the Group, we will be able to hit our 15% target.

Questions from Ms Cheryl Lee, UBS Singapore

I have some follow-on questions. With regards to the Infrastructure division, there was quite a good pick up quarter-on-quarter. May we have a bit more colour on whether the improvement was driven by milestones on the Hong Kong project, which perhaps is sustainable or is it more to do with Keppel's involvement with the Singapore electricity market which maybe is a bit more volatile. So just to understand how sustainable that performance is. Also, we noticed that you moved quite a number of units as well in property in Singapore as well as in Vietnam. Perhaps you can give some comments on underlying trends you have seen and what has helped particularly in Singapore and again an overview of the state of the residential market here.

LCH: I will ask TG Ong, CEO of KI, to answer your first question.

OTG: On the quarter-to-quarter comparisons, our environmental infrastructure is contributing because the Hong Kong project is contributing and Marina East Desalination Plant (MEDP) is contributing as well. So you see quite a nice pick up and we expect this contribution from Hong Kong to continue. For energy infrastructure, we actually announced importation of LNG last quarter, so that helps and that will contribute to quite meaningful savings all the way up to the end of the year. So we expect the contributions from the energy side to be also quite decent. On top of that, we have our services business, where we are operating all the plants throughout the world. That is also contributing and in a positive manner. So all three engines within the infrastructure side are actually firing and the result is very encouraging.

LCH: Thank you TG. If I can just add one more point, as we complete some of these new projects like MEDP and the Hong Kong Integrated Plant, they will also add to the O and M - the operations and maintenance - fees that we earn. So as each project is completed, we will keep layering and this will contribute to the infrastructure services. Can I ask Swee Yiow to answer that "favourite question" on the Singapore market?

TSY: For our China and Vietnam projects, I think we are experiencing very healthy demand. In China, projects sold are mainly in Nanjing, Wuxi and Tianjin, and you can see that when we launched Nanjing in particular, for every unit that we launched, it was 10 times oversubscribed. So the demand is pretty healthy and strong. For Singapore, I think our property market volume is at a steady stage, whether this year or last year, because we are mainly selling Garden Residences. We see a very stable sales volume that is passing through, so we expect that the market will remain relatively stable.

Questions from Ms Jane Tan, a retail investor from Singapore

Can you provide an update on the progress of M1's transformation? Are there any plans to cut costs as your competitors have done?

LCH: May I invite Manjot to speak on the transformation?

MSM: Our transformation strategy actually is multi-pronged. It has multiple elements in it, and the first proof of the pudding is in the launch of our One Plan that we did a month back, which is basically streamlining our tariffs, which were 19 in number, to one.

With the power of One and the flexibility of subscribers being able to create their own plan, and along with that we also simplified our website, the journey is very simple and the experience is very good. That is the first step that we have taken in our transformation journey, to align our complicated tariff plans into one simple plan and make the journey very simple. There are other elements of the transformation plan that are being worked on and when we come to a point where we can actually share, we will share more as we go along. But this is the first step. As far as the cutting of cost is concerned, we are looking at cost efficiencies but not necessarily in same manner as our competitors have done. We are looking at every part of the business, from processes that are being followed in the business, to tools and technology, how it can help in the business, as well as people. So it is not necessarily just about people, it is about creating efficiencies in every part of the business and we are reviewing every part of the business.

-END-