

Transcript of Keppel Corporation's 3Q & 9M 2014 Results Webcast

Question & Answer Session

21 October 2014, 5:30PM

Panelists:

LCH Loh Chin Hua, CEO of Keppel Corporation
CHC Chan Hon Chew, CFO of Keppel Corporation
CYY Chow Yew Yuen, CEO of Keppel Offshore & Marine

Mohammad Razali, Retail Investor: Why is Keppel not competing for a slice of the general drillship newbuilds market? Is it because the profit margin is low?

LCH: We are already competing in that market with the Can-Do Drillship. It took us quite a while to come up with a value proposition that can compete effectively in that market and provide us with reasonable margins.

Mohammad Razali, Retail Investor: Is the option for the first Ensco jackup still valid or has it expired?

CYY: Ensco's jackup option has lapsed.

Mohammad Razali, Retail Investor: When can we expect Keppel to complete the Doha North Engineering, Procurement and Construction (EPC) job? Any further cost provisions expected?

LCH: As we have said before, we expect the Doha North EPC project to be completed by next year. We believe that the provisions we have taken so far to be adequate. But we will only know when the project is completed.

Peter Gylfe, Balyasny Asset Management: A few questions on FLNG: 1) Now that you have the Golar HILLI in your yard, what's your confidence in that project coming in on time and on budget? 2) What's the timing for signing the second conversion contract with Golar? 3) You've talked before about \$65 billion in FLNG capex over the next six years, what is your capacity to do conversions? How many do you think you can do per year?

CYY: As I have said previously, we have gone into great detail to understand the risks and project execution. We are pretty confident of the project coming in on time and on budget.

On the second question, we have already received the letter of intent and hope to sign the contract before the end of the year. We will make an announcement when that happens.

As for the third question, we are looking at doing a mix of both FPSO and FLNG projects. We plan to do about two FLNG conversions per year.

Cheryl Lee, UBS: Good evening Keppel, 1) May we have an update on your Memorandum of Understanding (MOU) with Pemex? When is a firm agreement likely to be signed? How soon can the yard start operations once the shareholders agreement is inked? 2) My second question is on the DSSTM38E semis for Sete Brasil. As you have mentioned, the first unit is already at 75% completion. What major tasks are still ahead in

the construction and commissioning, and is the unit likely to be completed ahead of schedule? 3) When will the first revenue recognition milestone on the Golar LNG vessel be achieved? 4) My fourth question is on dividends. Keppel has typically paid around 50% of its earnings in dividends. Can we expect this to be maintained in 2014?

LCH: I'll start with your fourth question. Although we don't have a stated dividend policy, we have been paying about 50% of our earnings. Barring any unforeseen circumstances, we would expect that payment rate to be maintained this year.

CYY: We are in advanced stages of the discussion on the shareholders agreement. We hope to be able to conclude that agreement with Pemex around 1Q 2015. The yard is divided into several phases, and it will take about 18 months after we ink the agreement to start the first phase of operations.

LCH: What's relevant here as well is that we have the six potential jackup contracts. Even though the yard may take 18 months to start operations, we can actually begin work on the six jackups before then because part of those will be built outside the Mexican yard.

CYY: Yes, of course. The six jackups as you know have local content requirements. What Chin Hua mentioned is right, we can start the construction in Singapore and finish the rest in the Mexican yard when it is ready.

On the next question about the DSSTM38E semis - the remaining 25% of the first DSSTM38E semi comprises topside integration, mechanical completion and commissioning work. At this point in time, we are pretty much on schedule. With regards to whether we will be ahead of schedule, we will be very happy to announce it when it happens.

Regarding the Golar LNG vessel, we expect to achieve the first revenue recognition milestone in 4Q 2014.

Lim Siew Khee, CIMB: Hi, can you please elaborate on the \$23 million writeback on impairment of investments?

CHC: This relates to k1 Ventures' sale of an investment, and as a result of that we were able to write back \$23 million of the provisions made. We mentioned this last quarter, and it is of the same nature as the one we wrote back in 2Q 2014.

Lim Siew Khee, CIMB: How much did Brazilian contracts contribute to your 3Q 2014 revenue? Also, what's the key reason for the quarter-on-quarter improvement in operating margin for the O&M Division at 15%?

CHC: As we have always explained to investors and also analysts, it's not meaningful to look at the margins from quarter to quarter. I would characterise the margin as stable. If you look at the last three quarters, in first quarter we had a margin of 14.2%, and in second quarter, 14.7%, and then finally in the third quarter we had 15%. As you can see, margins have been very stable averaging about 14.6%, which is comparable to the same period last year.

As to how much Brazilian contracts contributed to revenue in the third quarter, it was similar to previous quarters, about 20%.

LCH: On this part about the margins, just like what Hon Chew said, we should not look at it on a quarter-by-quarter basis. We are very pleased that our projects are being executed well. So far, we have not had any negative surprises on our Brazilian projects. We have been able to execute according to plan both in terms of time and budget.

Gerald Wong, Credit Suisse: When do you expect to achieve initial revenue recognition for the third Sete Brasil semi since it is close to 20% complete?

LCH: We will be able to recognise it in 4Q 2014.

Lee Yue Jer, DMG & Partners: Hi, congratulations on a healthy set of 3Q 2014 results. I'd like to ask if management is concerned about the relatively low quantum of contract wins in 3Q 2014 and what range can we reasonably expect for FY 2014 as a whole?

LCH: Thank you, I believe we have had a good set of numbers, considering the current conditions. On the O&M side, we continue to see robust enquiries across our spectrum of solutions. 3Q was a bit slow in terms of the orders that were actually secured but rest assured that we are working very hard.

I think you are well aware that we do not give guidance in terms of order wins for the year.

Hu Yuanwen, Lianhe Zaobao: Keppel's share price has fallen by around 10% in the past month. Is this a reflection of the weak oil & gas market?

LCH: It is very difficult for me to speculate but the oil market has certainly gone through a turbulent time over the last few weeks, and this negative news has had an impact on the whole sector.

Malminderjit Singh, Business Times: What are the group's prospects in the jackup market given that the jackup market as well as oil prices are softening?

CYY: It is no secret that there are a lot of jackups being built both in China and Singapore. In fact, China has overtaken Singapore to build the most number of jackups this year. But we think that a lot of the jackups currently built in China are speculative ones, and will probably be used within China's domestic market. We also think that quite a number of projects are likely to be delayed, and hopefully the surplus jackups out there may be absorbed into the marketplace in the next one to two years.

Having said that, we are still getting very good and strong enquiries from NOCs and the regional operators. We are still optimistic about the prospects of jackups.

Ling Xin Jin, Morgan Stanley: What are the options outstanding in the O&M Division? Would you consider taking a similar equity stake in the second and third Golar FLNG vessels?

LCH: I'll answer the second question. We were quite happy to take the 10% stake because we believe that the Golar Hilli is a good project. As I have said in my remarks, it

is a good alignment of interests between the Keppel Group and our customer Golar LNG. We are open to looking at similar collaborations in future but nothing is firm at this stage.

CYY: On the first question about options outstanding in the O&M Division, most of the options are still valid. We are working closely with our customers to see how we can convert these options into real contracts.

LCH: There are seven options still outstanding.

Low Horng Han, Citigroup: With the sharp decline in oil prices, the consensus is that E&P capex will be under severe pressure for the next few years. What is your view on the E&P cycle? Do you think that the budget for NOCs, as a group, will still grow? Are there any pockets of strength or areas where Keppel is differentiated?

LCH: The main attention for the last couple of weeks has been on the sharp decline in the oil prices. That has had a negative pall on the market. But oil prices are generally dynamic. Many factors determine oil prices such as the operations of OPEC and production in countries which come under some political stress from time to time.

As oil prices come off from what it was (above US\$100 per barrel), some of the marginal producers will reduce their supply over time. And as oil price moves up, more marginal suppliers will come into the market. The key here is that at the current prices of about US\$85 per barrel, most of the offshore fields are actually economical to develop. And, as I have said in my remarks earlier, there is still a need to replenish the depleting reserves and to increase production.

We still believe that E&P spending will remain good in the medium to long term. Of course, in the short term, you can expect to see some oil companies kicking the can down the road and deferring some projects. But eventually, these projects will still have to come onstream.

We have said that NOCs like Pemex have very ambitious plans to grow their production. They have stated that they will be looking to invest. You will see investment growth in their E&P in the next few years.

We have pursued a *Near Market, Near Customer* strategy that has served us very well. In recent times, we have developed new customers and new solutions, and these are areas that we will continue to build up. As we develop existing customers, we are also looking for new areas where we can grow, be it in the Arctic or floating LNG.

Ajay, JP Morgan: Can you give us more details on the write-back in the Investment Division this quarter?

CHC: The write-back relates to k1 Ventures. Over the last few years, they have been divesting some of their investments. In the past we have made provisions for some of these investments, which were below the book value. So when these investments are divested, we write back the provisions that were not required. This was what happened with k1 Ventures this quarter when they divested Helm, a US company in the business of owning rail cars.

Hui Ban Yin: How effective has Keppel's response been to Chinese competition?

LCH: This is a very important area that we have been focusing on for a long time. The Chinese yards have become increasingly active in the offshore sector. Our focus on R&D and improving on our proprietary designs has set Keppel apart from our competitors. We will continue to invest in R&D to create new solutions for our customers.

Another area that I would say is a strong differentiator for us is our *Near Market, Near Customer* strategy. We have been operating 20 yards around the world. Keppel has had a long history of being able to operate effectively in closed markets like Brazil, the Caspian...etc. It is a strategy that is difficult for our competitors, including the Chinese, to replicate.

Malminderjit Singh, Business Times: Does the current uncertain political environment in Brazil along with recent corporate scandals in the oil industry there affect Keppel in any adverse manner going forward?

LCH: Keppel has been operating in Brazil for quite a number of years, and we have been operating through different administrations. It is a challenging environment but so far we have been able to navigate that market quite well. We work well with the administration there. The key is that we focus on the commercial work.

CYY: We are focused on being able to deliver projects on time, on budget, and to the quality that is required. As Chin Hua said, we have worked through several administrations in our 15 years in Brazil. The political situation there is constantly evolving but we have always concentrated on executing well, making sure that we have good relationships with our key customers and investing in our yard. I think that we continue to be in a good position moving forward.

Janice Chua, DBS Vickers: Can we have an update on the five jackup options from Transocean?

LCH: So far the options are still active. First option will expire next month, subsequent ones will expire every four months thereafter.

Lee Yue Jer, DMG: Based on enquiries, are we likely to see more contracts for drilling assets or production assets?

CYY: My opinion is that it will be about equal. The production assets at Keppel Shipyard whether they are FLNG, FPSO or MOPU projects will continue. On the drilling side, we are very hopeful of securing some orders moving forward.

Lim Siew Khee, CIMB: Just want to understand more about the provision for the writeback, since it has been recurring for the past two quarters. Are there anymore of such that you foresee in the coming quarters? Without guiding on future numbers, what are the triggers that we should be looking at for potential writebacks?

CHC: Those writebacks were triggered by the actual sale of the investments. I cannot give you guidance on when there will be more divestments from k1 ventures. They are a separately listed company, I cannot speak on their behalf.

James Yoon, BNP Paribas: I understand that you are working on a subsea construction vessel in the Baku Shipyard in the Caspian Sea. Should we be concerned about the potential profitability of such specialised vessels in which you may not have as much experience building? Are there any other such specialised projects, which we should keep on our radar screens? Perhaps the CAN-DO Drillship or Golar FLNG, both of which are vessels you are constructing for the first time?

LCH: We look at each project very carefully before we take them on. It is not just about winning the topline, we are also concerned about potential execution risks. We pay special attention to projects that we will be doing for the first time. If you have been following us James, you will know that before we did the Golar FLNG, we did a very extensive FEED study. And after the FEED study, there were a lot of questions from analysts on when the contract would be signed. It took awhile, and it was all for a good reason as we wanted to make sure that the risks were properly calibrated.

CYY: We have actually built subsea construction vessels before in Singapore, at Keppel Singmarine. This is not a new project to us. I think what you are alluding to is that it is the first time for Baku Shipyard in the Caspian Sea. Let me explain that the engineering, procurement and construction methodology are all done in close collaboration with Keppel Singmarine. In fact, part of the vessel will be built in Singapore, and it will be brought over to the Caspian Sea for integration and the outfitting at Baku Shipyard.

Just like our projects in Brazil, we give a lot of thought to the execution before we finalise the plans and conclude contracts with our customers. We have done a jackup and a semi in the Caspian Sea before. We are also currently doing the DSS™38M in there. Again, a lot of the work such as engineering and procurement are done here with the support of our Singapore office. In this respect, the risks are minimised.

Lim Siew Khee, CIMB: Would you say that your enquiry levels are equally strong now versus three to six months ago? And is it fair to say production-related enquiries are stronger versus exploration?

CYY: Enquiries from NOCs and regional drillers for jackups are still as strong as three months ago. As for production enquiries, we have to look at it at a regional level. For example, Brazil is still very strong in production, even though we are building drilling semis there. In Baku, drilling semis and production semis are of equal importance. We are still getting a lot of production enquiries at Keppel Shipyard and many drilling enquiries at Keppel FELS. As I have said, it is about 50-50 between production and drilling.

Mohammad Razali, Retail Investor: Has Keppel concluded the design of the ice-worthy jackup in collaboration with ConocoPhillips?

LCH: As we have discussed before, we have concluded the work but commercialisation will take awhile. A lot of projects we look at have long gestation periods. So we are not looking at them on a quarter-to-quarter basis.

Mohammad Razali, Retail Investor: Can we expect more semis from SOCAR anytime soon?

CYY: There have been discussions on more semis. We will make the announcement when we have secured such contracts.

Ling Xin Jin, Morgan Stanley: Could you please repeat the revenue contributions from the Brazilian operations? Also, what is the status update for P-66 and P-69? Any recognition yet? Any timeline expectations?

LCH: 20% of Keppel Offshore & Marine's total revenue comes from Brazil-related contracts.

CYY: We are on schedule and on budget for both projects. On P-66, our scope entails the fabrication and integration of topside modules. The hull is being done by another yard in Brazil. There are some delays on the hull and we are waiting for Petrobras to release it to us. We are also very much on track with our scope of work on P-69.

<End of Q&A session>