

Keppel Corporation Second Quarter and First Half Results Briefing for Analysts and Media

Question & Answer Session

21 July 2016, 5.30pm, Keppel Leadership Institute

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
AWG	Ang Wee Gee, CEO of Keppel Land
OTG	Dr Ong Tiong Guan, CEO of Keppel Infrastructure
CT	Christina Tan, CEO of Keppel Capital

Aradhana Aravindan from Thomson Reuters: I just want to check on your orderbook, when was the last time it has reached this low?

LCH: The last time was in 2010, when the net orderbook was \$4.6 billion.

Cheryl Lee from UBS: Firstly, on the operating cash flow, there was a negative working capital of about \$811 million in the first half of the year and about \$150 million in the second quarter. Can you quantify how much was from O&M? And also, how much more working capital will O&M require in the coming half year? The second question I have is about Tianjin Eco-City. You mentioned about parcels of land being sold. Can you just give us a sense of what is the GFA of residential plot area left which is available for your JV to sell?

CHC: Most of the working capital requirements actually came from Offshore & Marine. Of course for the property business, there is also the working capital for the development of the properties. I won't be able to give you any projections, but it suffices to say that with the slowdown in the industry, there is going to be less demand on working capital. On the other hand, with the deferral of some project deliveries, some of the receipts will be shifted to future years. So, balancing both we do not expect major changes to our working capital requirements.

LCH: As I said in my opening remarks, the growth in working capital requirements for O&M has plateaued in line with the slower work. The second question you have with regards to Tianjin Eco-City, about 40% of the residential, commercial, and industrial land in the Eco-City has been developed or has been sold to third parties for development, so we still have about 60% left.

Gerald Wong from Credit Suisse: Firstly, for the offshore and marine division, what is the scope for further cuts in your direct and subcontract workforce? I noticed that the pace of decline in the subcontract workforce has actually slowed down in 1H2016. Secondly, can you provide an update on the first FLNG conversion for Golar and the expectations for the second and third units to go ahead? Lastly, on Keppel Capital, can you provide an update on the regulatory approvals?

LCH: I'll ask Mr Chow to answer the first two questions and the after that Ms Tan will answer the third question on Keppel capital.

CYY: For the first half of this year, we have reduced our direct staff strength in Singapore and overseas by 4,900. Subcontractors, like you rightly pointed out, we only have reduction of 690. But if we were to look at what we have done since the beginning of 2015, we have actually reduced our global direct workforce by a total of about 11,000 and our subcontract workforce in Singapore by about 8,500. This process of rightsizing actually started more than 18 months ago, since the beginning of 2015. In responding to the changing market conditions, we will see how we can continue to rightsize. We are leaving no stones unturned.

The first FLNG project, the Hilli, has been contracted and is going to Cameroon. The project is coming along fine, delivery is scheduled for some time in June/July next year and we are on track to deliver that project.

LCH: Before Chris answers the question on Keppel Capital, just to add to what YY has said, we do have some flexibility in how we position our workforce because we have both direct and indirect labour. As what YY said, there is definitely enough scope for us to make changes as required. But in times like this, where there are projects being completed, it makes more sense to keep some of the indirect labour for a bit longer.

CT: On the question on the regulatory approval, we have received MAS approval on the consolidation of our interests in the various REITS and fund managers.

Kyunghee Park from Bloomberg: You mentioned in your release about mothballing your yards as you see demand. Could you elaborate a bit further – are you planning to temporarily shut down some of your yards? Which are the yards you are looking at mothballing if that is the case. My second question is on orders; are the enquiries still coming in or have the enquiries basically stopped coming in for you?

CYY: We are responding to the market situation. As you know, we started from a very high base from the last 7 or 8 years. At this time, when the orderbook is lower than it used to be, we have some overcapacity. We do not rule out the possibility that we may temporarily mothball some of our facilities, so that we can concentrate and reduce the overheads. We will make a further announcement when we have reached a decision, and when the time is right.

LCH: When we mention about mothballing, this is just something that we can consider. As YY said, we have built in quite a lot of flexibility in our production, in terms of the workforce and the yards we have. We have more modular yards instead of one big yard. And not that long ago in 2013, we built 21 rigs which was a world record. That was when the market was good, so we were able to take all these orders and expand our production capabilities. But at the same time, we are always mindful that this is a cyclical business. We try not to over invest in capacity building. We also allow some flexibility in our production and our workforce precisely for a situation like this, where things might be a bit slower temporarily. But we are not going away, we are going to come back strong.

CYY: Actually, the ability to mothball means we have a lot of flexibility like what Chin Hua has said. I think it is a problem when you're over-invested and you have less flexibility. This is when it becomes a structural problem. So I think to me, the ability to mothball and maybe bring the best efficiency and productivity into a more concentrated work area is positive.

Now you have a second question, which is about the orders and enquiries. I think what we have to recognise is that currently, like what Chin Hua has mentioned in his opening address, there is some oversupply in the rig market and with the falling day rate, we actually do not expect demand for drilling rigs to return soon. And that's one of the reasons why we're looking at mothballing and reducing capacity, as well as rightsizing.

However there are some good positive indications, because there is an increase in enquiries in a number of areas: production platforms, FSRUs, and also gas-related projects. In the specialised vessels segments, we have dredgers, ice-class vessels and Jones Act vessels to look at. So I think while the industry capex cycle will take time to stabilise and recover, we must prepare for a long and harsh winter, like what Chin Hua has said in the opening address. I think that is the prudent thing to do.

Jacqueline Woo from Straits Times: Does Keppel expect to further reduce its headcount for both direct and subcontract staff in the second half of the year, aside from natural attrition? If so, by how much more?

LCH: We have to get the organisation sized appropriately for the tough times ahead. So all options are being considered but we have not made any decision at this point in time.

Ong Chin Yew, investor: Could you provide us with a latest update of the drillship? Any cost overruns as compared to the initial set budget?

CYY: The good news is that there is no cost overrun. The progress is coming along fine. I think in the last report, I have mentioned that we are able to slow down construction because we are building it on our own account. So, we can actually time it for the market. Right now, the vessel will come back from Japan probably end of this year, as you know we have contracted the hull to IHI, and we will take our time, probably a year to complete the vessel. We are timing it to suit market conditions.

The other thing about the drillship is that because this is not a commodity rig, as you know, this is actually designed for a purpose, it is a development drilling unit. So that one we actually have some active enquiry. We are timing it and the good thing is that we are able to keep everything under control.

Gary, Value Investing: Given the rising debt-to-equity ratio, what is the comfortable level of gearing? Is Keppel looking to divest some of its non-core investments (for example k1, M1 etc.) to lower the debt level?

LCH: Well Gary, I think you have heard Hon Chew, CFO, say various times that the comfortable gearing is we want to stay below 1x. So we are quite far from that. I think more importantly, you can see that our gearing ratio at least for the last two quarters has not grown as quickly. As I said in my opening remarks, we are still at a very comfortable level.

Having said that, we do have some investments as you pointed out which are non-core. We are always looking to monetise them so investments that are non-core. It is not because of our gearing level, which I would emphasise that we are very comfortable with, rather, we want to find opportunities to monetise our non-core assets so that we can redeploy the capital to earn a better return.

Joshua Lee from Deutsche Securities: I'm just wondering whether Keppel O&M is open to collaboration or has collaborated with your other O&M peers, such as Sembcorp Marine, during this downturn?

LCH: I don't think we have collaborated before. In this cycle, the problem in the industry is capacity. So adding new capacity, whether it is with Sembcorp Marine or someone else, doesn't help at this present time. It is really about hunkering down and I think Keppel has been very fortunate because whilst we have made good money in offshore & marine over the last decade, we have been quite prudent about how the monies have been invested.

Being a multi-business company, we were able to redeploy the capital or the profits we made to other divisions within the Group. You can see that we have not really invested excessively in new capacity building and I think we're in a pretty good position. The market is tough, as I said, but I think we are quite well equipped to handle this downturn.

Ling Xin Jin from Morgan Stanley: I have two questions regarding the property division. Firstly, will you be able to share if you have a target for the number of units that you plan to sell this year, as well as next year? Also, you mentioned that you have about 18,000 launch-ready homes but you also have a strategy of improving your inventory turn. So at what level of inventory of launch-ready homes will you be comfortable with?

AWG: We have indicated that we currently have a land bank of 70,000 units, of which almost 40,000 are in China and another more than 20,000 in Vietnam. With this land bank, we will be able to have this inventory to be developed over many years.

Looking at the stages of construction for our projects, we could launch about 18,000 units over the next two and a half years. We could expedite the construction for some of the other projects, so we can even bring in more units to be launched over the next few years. We will try to turn our inventory as quickly as possible but it also depends on the market. The outlook for the key markets we are investing in China and Vietnam looks good in the next few years. For these 18 000 units, if you look at our past sales numbers, we will be able to exceed them. For this year, we expect to sell more units than what we did last year.

Conrad Werner from Macquarie: You mentioned that you had Sete provisions, and you are comfortable with those. But you have a few more deferrals in the earlier part of this year from the non-Sete part of the orderbook. How often does that part of the business get reviewed for potential provisioning? Is it once a year or do you look at it every quarter? Given that we have a few more of these deferrals are we close to seeing to seeing some more provisions on that aspect of the orderbook?

LCH: The short answer is that we will review every quarter. We have an independent board and it has a very strong Audit Committee. And the AC looks at it. Keppel Offshore & Marine also has a separate board, which also has a risk and audit committee and they also look at it. And we have auditors looking at it every quarter.

CHC: Yes, we have some further deferrals, but as we review that every quarter, we look at things like the quality of receivables. We have always been disciplined in taking orders, so all the receivables at the minimum would have substantial deposits. Our customers are well established customers, not speculators. We have gone through very rigorous review with our committee, with our auditors every quarter, so as of now we do not need any provisions.

Cheryl Lee from UBS: I have a follow up question on Offshore & Marine. Can you provide an update on the semisubmersible projects not for Sete but for SOCAR, as well as the undisclosed? What is the payment status and the delivery outlook?

CYY: We will be delivering two semis in the second half of this year: one is to Floatel and the other one to SOCAR. The SOCAR project is on progress payment terms, so the risk of owners not taking delivery is definitely not there. In fact, the owners are keen to take delivery because there is a lot of drilling to be done in the Caspian Sea. The progress of it is that we are coming along with it very well, so I think we are quite happy with the progress, interim progress that we are achieving. As you know, this project is supported by Keppel FELS, and Keppel FELS is also sending a lot of our experts over there for testing and commissioning. That project is doing very well.

Tan Hwee Hwee from Business Times: It is gratifying that Keppel is still looking at pockets of opportunities in O&M. Now that the oil is holding up at \$40-\$50/bbl, could you share sentiments and projections regarding the sectorial recovery, if any?

LCH: If you had followed my opening remarks, you would learn that we think the long term prospect for the industry is still very bright, but we are prepared for a long and harsh winter.

Tan Hwee Hwee from Business Times: There are analyst reports warning against loss of human resources in the oil & gas and offshore & marine sectors. How quickly do you think your human resource policies can respond to the swings in the O&M market?

LCH: We have in the design of our production system a lot of flexibility for how we respond to market conditions. When times are good, we can build 21 rigs. But at the same time, we do not over invest in capacity, so that when times are tougher like now, we are able to rightsize without causing too much disruption.

Lim Siew Khee from CIMB: When do you see a realistic timeline resolution with Sete Brasil? What are the options being discussed?

LCH: The resolution is something that will take time, and we are looking for win-win solution. I think that the key here is that the rigs that we are building or in the process of building, are in Brazil and we believe that they are needed there. We will have to take a bit of time to work through this because there are quite a few stakeholders involved.

Lim Siew Khee from CIMB: Why did property's profit drop to \$94m in 2Q 2016 from \$105m in 2Q 2015?

LCH: I think CFO has answered that but maybe you can repeat.

CHC: Well in the 2Q, I'm sure you've noticed that despite the increase in revenues, the net profit dropped. That's actually because last year, there were some write back of cost accruals after finalising of accounts with the main contractor. As a result of that one-off last year, this year's profits seems lower by comparison.

Morris from Wilmar International: May I know what will be the dividend issued to shareholders?

LCH: If you are asking about the interim dividend, it is 8 cents per share.

Ke Yan from Smartkarma: Given the run-up of the M1 share price recently, is it a better time for your company to decide on the sale of stake in ASEAN to Asiata?

LCH: This is not a question that we can answer.

Ke Yan from Smartkarma: Based on what is on your orderbook, if there is no further delay request, would you expect the O&M revenue to be the same level of revenue as the first half? If not, what would be the ballpark level of run rate for the second half?

LCH: We don't give projections.

Ke Yan from Smartkarma: Could you recap on the \$1 billion term loan in 1H2016 under current liabilities?

CHC: I think the question is really comparing the short term loans as of the quarter end against the end of 2015. The increase is mainly the short term loans of over a billion that are on short term rollover, but they are actually backed by committed lines that we got from the bank.

Ke Yan from Smartkarma: What is the total investment expected for the Myanmar-based projects?

AWG: We have three projects in Myanmar currently. Two of them are hotels which we had built several years ago. They have been completed and are now operating. These two hotels we have written it down some years ago and we have just completed a new wing for our hotel in the Sedona Yangon. We have

invested in a new project, the office component of a mixed-use development called Junction City in the heart of Yangon. Our investment in Junction City is US\$47 million and the new wing of Sedona Yangon is about S\$100 million.

Reagan Lim, investor: Does the group have plans to privatise Keppel Telecommunications and Transportation?

LCH: I cannot answer that question.

Mayuko Tani from Nikkei: May I confirm there have been no additional provisions made in the past quarter after the \$230 million provisions made for Sete last year?

LCH: Yes, we can confirm that.

Mayuko Tani from Nikkei: Among the differed contracts, are there any contracts that you may possibly need to provide for, for the rest of the year?

LCH: No, at this point I don't think so.

Mayuko Tani from Nikkei: Your description of winter becoming from "long" to "long and harsh" in the last quarter. What made you change the way of how you see it?

LCH: I think the point is that from what we have seen in the industry and as I have shared, it is not just about the fact that oil price has recovered. We also have to look at the situation with the oversupply of rigs and the current situation with our traditional customers that they may need a bit of time to get their balance sheet repaired before they can order. So for all these reasons, it is prudent for us to be prepared for not just a longer winter, but also a harsher winter. But let me assure you that our colleagues are ready, so the moment we can sniff the recovery, we will be out there and we will be able to respond to the changed market conditions at that point in the time.

Lim Siew Khee from CIMB: Why did Infrastructure profit improve quarter-on-quarter to \$27 million in 2Q 2016 from \$14 million in 1Q 2016?

OTG: For the second quarter, the gas-to-power businesses have performed better, as well as the infrastructure services business. The two of them contributed to better performance in 2Q.

Lim Siew Khee from CIMB: With power prices in Singapore coming down, how did gas to power do better? What is infrastructure services?

OTG: Our power and gas business is an integrated business. We don't just look at the power price. We optimise our gas as a feed-stock to our power production. Through our optimisation, we performed better in 2Q. Infrastructure services is where we group all our operating staff who operate our plants. We have performed better because Doha North started operations since December last year. So, there are contributions from the Doha North operations.

Pang Han Lim, retail investor: Any intention of going in the building wind turbine, solar panels, or defence equipment like naval vessels?

LCH: You have heard from my presentation that we are looking at different segments, and renewables are certainly one of them. I am not sure that we will actually go into building solar because that is not really our core competency but we can certainly look into going into renewable projects like wind, offshore wind, where we have some expertise.

Max from Oxbow Capital: Are there any debt governance related to multiple of EBITDA? I'm concerned about the leverage given that debt increasing in a period of earnings decline. Is it more prudent to reduce your dividends further?

CHC: We do not have the issue of governance. Our gearing, as CEO mentioned earlier, is at manageable levels. We do not foresee our gearing to go anywhere close to 1x. So it is not an issue for us.

LCH: In deciding the dividend to pay, the board, working together with the management, looks very closely at paying a dividend that is sustainable, taking into account our balance sheet and taking into account the capital requirements for the business. So rest assured that whatever dividend we have declared, it has been discussed at length and it is a dividend which we believe we can pay and is sustainable.**Nicholas, investor:** Any near term plans to IPO Keppel Capital once stabilised? For example, dividend in species of this business unit if you list it?

LCH: The short answer is no. With Keppel Land now privatised, all the key divisions are 100% owned and I think this is quite important for us to be able to allocate capital freely within the group. It has worked well for us and I believe it will continue to work very well. So you have to invest in Keppel Corp.

– END of Q&A session –