

## Keppel Corporation 4Q and FY 2016 Results Briefing for Analyst and Media

### Questions and Answer Session

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<b>LCH</b>	Loh Chin Hua, CEO of Keppel Corporation
<b>CHC</b>	Chan Hon Chew, CFO of Keppel Corporation
<b>CYY</b>	Chow Yew Yuen, CEO of Keppel Offshore and Marine
<b>AWG</b>	Ang Wee Gee, CEO of Keppel Land
<b>OTG</b>	Ong Tiong Guan, CEO of Keppel Infrastructure
<b>CT</b>	Christina Tan, CEO of Keppel Capital

**Low Horng Han from CLSA:** With regards to the provision for impairment charges, we know that Keppel has always been very prudent with capital spending. Thus, I am rather surprised by the impairment magnitude of \$336 million. Which are the yards that are affected? Is there any breakdown you can provide in numbers? Secondly, what are the parameters for the impairment test - Is it largely based on cash flow? And does the order book outlook still signal a fairly harsh winter ahead?

**LCH:** Thank you for the comments. You are right, Keppel is known for being prudent. We are going through a very long and harsh winter so it is not business-as-usual. The steps that we are taking to rightsize Keppel Offshore & Marine (Keppel O&M) to make it stronger and more efficient for the future necessitates that we take some fairly strong actions in terms of capacity, which then results in this. So a lot of the impairments are related to the rightsizing exercise.

**CFO:** As CEO has mentioned, offshore and marine is undergoing rightsizing. In the process, we have also reviewed the capacity of the whole network of yards globally. We also reviewed all the fixed assets in the yards and did a comparison between our book costs against net realisable value. Together with our auditors, we have identified certain fixed assets that we have to make impairment provisions for, which has resulted in the impairments that you see in the financial statement. This review is quite a robust process. In addition to the auditors, it has also gone through the Keppel O&M Audit Committee and board as well as Keppel Corporation's Audit Committee and board.

**LCH:** No one likes impairments but if it is necessary, it is right that we do that. You must look back at how Keppel O&M has run its business through both the upcycle and the downcycle. We have always been very judicious in the use of capital, many of our yards are not new yards. Given what we see today, if we had invested even more in our yards during the good years, the impairments might be worse. So even though it is a negative, it also reflects the fact that we have been quite disciplined in how we have used capital throughout the cycles.

In terms of outlook, of course we are happy that oil prices are starting to pick up. But we are also quite realistic. It may take some time before it flows down and the market is also overbuilt. But we are not stopping there, from my presentation as well as earlier presentations during the last few quarters, you can see that we are also looking for other new markets – gas for instance. We are also looking at non-drilling, going into production and new markets like dredgers and repurposing our technology. This is really key to us. It is not just a question of rightsizing but also looking for new markets and new revenue streams.

**CYY:** To add, like what CEO has mentioned, we were at our very high point, and if we were to look at how we had built up to the high point and how the market has softened, we have to do the prudent thing. As mentioned in CEO's speech, we have mothballed two of our overseas yards. To clarify, when we say yards, these are supporting facilities, not primary facilities. In Singapore we have seven yards. During the good times we have also gone in and acquired some of these supporting facilities. So what we are doing is that we are mothballing the two overseas yards and trying to see how we can reduce the capacity in Singapore, which amounts to three supporting yards. So don't misunderstand, the primary yards remain very much intact. In fact, one of our objectives is to maintain our capability and core competence and prepare ourselves for the next upturn.

**Cheryl Lee from UBS:** On the topic of impairments, please clarify the \$82 million provisions for impaired stock and work-in-progress, how much actually relates to property? Because I think in the notes it was said that it was property and Keppel O&M. My second question is that of the \$87 million in fixed assets, is this largely mothballed yards? For the investments, can we gain more clarity of the \$121 million, how much is O&M related, how much is in investments, and is there any in KrisEnergy? And when you mothball a yard, is the cost related to reinstating the land taken through P&L as a cost item or a separate thing, like impairment charge?

**CFO:** Stocks and work-in-progress are largely due to the provision for the Can Do drill ship. At the year-end we did a value-in-use review and had a third party valuation to support the provision that was made. That's the biggest item under stocks and work-in-progress.

For fixed assets provisions, as I have mentioned, it is actually a review of fixed assets in the yards, comparing the net realisable value against the book value. In some cases, it is actually looking at value-in-use of the yards and arriving at the provision for impairments.

For investments, it includes the impairment of various investments, including yards and also in some listed companies. So I'm not at the liberty to break them down.

As for the mothballing, in cases where there is a need to reinstate the land, of course part of the cost of reinstatement would be included in impairment, but I don't think there is significant reinstatement costs in our case.

**Lim Meng Liang from Aires Investment Holdings Private Limited:** How has the rebound in oil prices helped the profitability of Keppel Corporation?

**LCH:** As I alluded to in my opening remarks, I think the rebound in oil prices sets the necessary stage for the eventual recovery of the offshore sector but it is not the only condition. We still need to see improvements in terms of the utilisation rate of the existing fleets as well as a period of time for the excess rigs, new builds to be absorbed. More importantly, the rebound in oil prices will lead to more substantial increase in E&P spending. So it will help, but it is not a direct correlation.

**Lim Meng Liang from Aires Investment Holdings Private Limited:** Will there be an increase in order book for 2017 and 2018? (Oil and Gas)

**LCH:** We don't give any forecast in terms of order wins but certainly the team is working very hard not just at drilling rigs but also looking at assets, like production assets as well as gas and non-oil and gas. We are working very hard to fill the order book.

**Lim Meng Liang from Aires Investment Holdings Private Limited:** How will an expected increase in fed interest rates and Singapore dollar interest rates affect Keppel Corp in general?

**CFO:** As you know, Keppel Group is in a net borrowing position and of course any increase in Singapore interest rates will result in higher interest expense but that said, a point to note is that we have a prudent mix between fixed and floating. Suffice to say, fixed is more than 50% of the whole portfolio and that will help to mitigate increase in interest rates.

**Lim Siew Khee from CIMB:** Just wanted to clarify the impairment, because you actually have a few lines of impairment, just wanted to know how much do you record? Total impairment provision that you took in O&M in 4Q - Impairment of fixed asset how much, provision for stocks how much, and I know there is a \$12 million provision for doubtful debts.

**CFO:** For O&M, the total impairment for the fourth Quarter is also about \$270 million. If you look at SGXNet there is disclosure for breakdown but that is for the Group but the offshore & marine is the biggest part of the numbers you see. If I may refer you to page two of SGXNet, the impairment of fixed assets for the fourth quarter is \$87.4 million; the impairment of stocks and work-in-progress is \$81 million; and the impairment of investment and associated companies is \$121 million.

**Lim Siew Khee from CIMB:** For O&M revenue, compared to 3Q of \$500 million, 4Q is relatively strong of \$800 million. Is there any specific ad hoc things you are doing? Why is it so strong?

**CYY:** It's just the timing of the projects. In fact the team is working very hard on some repairs. So it's just timing.

**Lim Siew Khee from CIMB:** Another thing, there is a negative \$70 million of operating profit in investments, so that is because of your listed companies impairment that you can't disclose? Also for revaluation gain for property, last year was \$128 million, this year is \$63 million. So which areas do you see it coming from?

**CFO:** Sorry we don't give a breakdown. But generally there is a reduction in fair value gain of office buildings.

**Tan Hwee from Singapore Press Holdings:** Congrats on winning the desalination contract. Can you elaborate on the technology that may be applied to this project? Particularly of interest is if any synergy will be derived from your offshore and marine division?

**LCH:** To address the second part of your question, this project is based on land in the Marina Barrage area. I think it will be a very interesting and iconic project when it is completed so Keppel is very pleased that we are selected to do this. Unfortunately, there was a very tight time schedule. If there was a bit more time, perhaps a possible solution might have been a floating unit which of course will bring in our offshore and marine division. So maybe the next time, on another project we can see this happen. For this particular project, we are pleased to have the trust of PUB and Keppel will work very hard to make sure we deliver on time, on budget, and safely.

**OTG:** The technology we will be using for this project is reverse osmosis, RO, technology. While we try to create synergy for the O&M divisions, this project will create quite a lot of synergies for the infrastructure divisions. We are investing in the project, building the project, operating the project for 25 years and we are supplying electricity to the projects for the next 25 years as well.

**Gerald Wong from Credit Suisse:** I have a few follow up questions on the provisions that were taken. Apart from the Can Do drill ship, were there provisions taken for other rigs? And what is

the outstanding carrying value of KrisEnergy on your books? On the yards that were closed or mothballed can you mention what are the overseas yards, and which Singapore yards have been closed?

**LCH:** I'll answer the last question. As Chow Yew Yuen has explained, the overseas yards that we have mothballed are actually supporting yards. One is Bintan Offshore, the second one is in Brazil, and this is in Santa Catarina.

**CHC:** On your question on the impairment on rigs. No, the only impairment on rigs is for the Can Do drill ship. On your second question on KrisEnergy, the net book value is about \$390 million as at 30 September 2016.

**Joshua Lee from Deutsche Bank:** What is the impairment breakdown of \$336 million by segments? And from the O&M segment, which projects were impacted? Are there any impairments from your Brazilian yards? Any guidance on your O&M order book for 2017?

**LCH:** I believe these have been broadly addressed in both my speech as well as CFO's answers to the questions earlier.

**Joshua Lee from Deutsche Bank:** Why is there a significant decline in other non-current liabilities?

**CHC:** That is largely due to the reclassification of long-term loans to short-term loans and also derivative liabilities because of the maturity of some of the fixed assets forward exchange contracts.

**Tan Hwee Hwee from Singapore Press Holdings:** Regarding the adjacent markets flagged for offshore and marine, can you provide more colour what they may be? What opportunities do you see for instance from offshore wind sector

**CYY:** Besides our core businesses, we are looking at opportunities in for example, power generation, desalination, and dredges which we already achieved some success there, and some specialised gas projects like small gas distribution projects and small scale FSRU, for which we had built up capability over the last eight years. These are the kinds of adjacent markets we are targeting.

In the offshore wind, we are pursuing opportunities in sub-stations, some of them are in the self-elevating platforms, so we are using our jack-up technology. We are also pursuing opportunities in production units such as compression modules, those are for the self-installing platforms which are jack-up technology. These are some of the things we are doing. In offshore wind, there are opportunities for us to fabricate some of the supporting sub-structures. Depending on the location, we will look at these opportunities and what is suitable for us.

**Lim Siew Khee from CIMB:** Just on O&M, since you said they provided \$270 million in 4Q, if I took that out, your EBIT margin is tremendously good at 17%. That is one-off related to some repair job?

**CYY:** No. It is actually 18%, which is higher than 17%. That is one of the reasons for our rightsizing efforts. The other reason is that we had some write backs for the completed projects for 2016. The margins are better with a combination of that and the repair jobs. When you add those together, our fourth quarter was actually 18.8% and for full year it was 14.4%.

**Lim Siew Khee from CIMB:** How much is the right back in 4Q?

**LCH:** We don't disclose that. But the write backs have an impact because it is not tied to the revenue.

**Lim Siew Khee from CIMB:** So what you achieve in the full year is something you look forward to or still on hindsight?

**LCH:** So you've been following us for a while. We never give forecast on margins. I think the key for Keppel O&M and it's already quite an achievement that in this tough environment with strong headwinds, KOM is able to eke out a profit while many of its peers are in the red. For us, it's rightsizing, making sure we are ready for a long winter, but more importantly it is to prepare for the future and to be more competitive. Keeping it profitable is already quite an achievement. If you look at KOM, it has been a big contributor to the Group's net profit for many years and in recent times. Now we have other engines, so we are waiting for KOM to eventually come back, and it will, we believe. So we are getting ready for upcycle but in the meantime we must still be prepared it will still be a few years.

**Gerald Wong from Credit Suisse:** Property had very strong sales in 2016. What is the outlook for property sales in 2017, particularly for key markets China, Vietnam and Singapore? Thank you.

**AWG:** As you know, our key markets are China, Singapore, Vietnam and Indonesia. In China, the government has introduced cooling measures but we see the market as being fairly healthy this year. Economic growth may not be as high as in the past, but it is still very respectable. Our projects are still selling well, so we think that the market will remain healthy this year.

Vietnam is a bright spot amongst the counties that we are focusing on. In the last one or two years, we have seen the market come up very strongly. We are very fortunate to have been in Vietnam for many years. Our team there has built a strong reputation and brand name as well as good connections and relationships, which we are capitalising on. On top of that, we have built up a large land bank in Vietnam. We are capitalising on this to push out sales as much as possible. We have launched 4 projects in the second half of last year. The sales were very good. We still

have land in Vietnam and will continue to launch projects in quick succession. For example, we launched Linden Residences in the Thu Thiem district at the end of last year. The project has around 500 units and we sold 400 units over a weekend. For that project, we have 6 residential plots. We are going to launch the next plot very quickly and then we have some more plots to launch. So we are expecting that Vietnam will be good for us this year.

For Indonesia, the market is still subdued. With continued economic growth in a low interest rate environment, we think the prospect is good going forward.

Singapore, all of you know very well. We see the market being subdued this year. We will continue to sell Highline Residences and The Glades. Last year we sold double the amount as 2015, and we are confident we will sell out these units this year.

**LCH:** Thank you Wee Gee. Just to emphasise what Wee Gee has said, Keppel Land has been fortunate that we gone out of the Singapore market for the past 20 years. We are quite well established in some of these growth markets like China and Vietnam. Vietnam has done exceedingly well in recent times in terms of sales. The land bank that Wee Gee talked about that we have amassed in Ho Chi Minh City is actually in very good locations. For instance, we have a plot of land in Saigon Sports City that is in District 2 and is 65 hectares. We are fortunate because this land was built up over the last period of time and we have a very strong team on the ground. We have planted the seeds, so now is the time to do some harvesting. That is one of the key strengths of the multi-business model that Keppel runs. We always have opportunities in various parts of our business to contribute the profit for the group.

**Cheryl Lee from UBS:** Relating to the write backs for Offshore & Marine that you mentioned, can we understand the circumstances that allowed you to write back whatever amount it was? A follow up question on property, in China, what are the opportunities for landbanking in the cities you are focused in, or would you look at expanding to other cities?

**CHC:** When you complete the project, you will then finalise the project costs. That is the point in time where you know the actual cost is actually what you projected, and you can write back at that point in time.

**LCH:** Before I invite Wee Gee to tell you a bit about what are some of the cities we are looking at in China, I just want to remind all of us here that we have about 66,000 units in the landbank pipeline for Keppel Land. Based on the sales last year, that is equivalent to about 10 years of supply. Keppel Land is in a very enviable position where we can buy land, and we have bought land in 2016, but we are not forced to buy land. If we find pieces of land that are attractively priced, we will do so. But we do not have to buy land unless it is attractive.

**AWG:** We are in 10 cities in China, but we focus on five. We believe that we need to focus and scale up in some of these fast growing cities so that we can be as competitive as the local developers. In terms of the strategy for landbanking, as Chin Hua said, we have 66,000 homes in the pipeline, of which half of them, about 33,000, are in China in these cities. So we are not in a hurry to buy land. When land price is higher, there is a saying in China that the flour is more expensive than the bread. When that is the situation, we do not buy land. We will take the opportunity to recycle our assets. Last year we sold two of our townships, one in Chengdu and one in Wuxi, and that was to capitalise on the land price which was higher than the apartment price. We will wait for opportunities for us to build our landbank.

**Ajay from JP Morgan in Singapore:** Can we confirm that O&M provisions are only for yard assets, or has Keppel also provided for any of the outstanding orders?

**CHC:** As explained earlier, the provision for impairment first of all relates to fixed assets. So yes, those are yard assets. On the work-in-progress and stocks, these are also yard assets. On investments, we confirm that we have not made any provisions on the outstanding projects.

**Joshua Lee from Deutsche Bank in Singapore:** Term loans and creditors increased 1.3% quarter on quarter, but interest expense increased 45% quarter on quarter. Why was the interest expense increase so steep?

**CHC:** For the first question, the interest expense is higher because of an accounting adjustment that was done in the fourth quarter, which is a fair value adjustment to a loan receivable from one of our associates. In accounting, when there is a bond or a loan, you have to compare the interest rate to the market interest rate, and if there is any difference you need to do a fair value adjustment to recognise interest expense upfront, and then recognise that difference over the term of that loan. In other words, in future years, it will come back in the form of interest income. If you remove that adjustment, interest expense for the quarter is comparable to the same period last year.

**Mohamed Razali (Retail Investor):** Could Keppel provide an update on the progress of its seabed mining project?

**CHC:** We continue to work on this project with our partners. We have done the first cruise and the results were very much in line with what we expected. Now the challenge is to develop a solution to bring the nodules which are situated 4km below the sea surface to the surface, so that we can process it. This is something we are working on with our partners. It is not a short term project. We have gone into this project with the view that this is going to be a long term project. It is a very exciting project. A second cruise will be planned in the next few years.



**Lim Siew Khee from CIMB:** On the Parden rig, it says that you actually had an agreement with the guarantor at the sale price matching the remaining payment obligation of Parden. Because it is a 20-80 payment term, do we need to writedown the contract value? How do we see it accounting wise?

**CHC:** We have received the 20% deposit. In other words, with this contract, we are made whole. We will still receive the remaining 80% because of this contract from the guarantor. Essentially there is no change. We had a very credible guarantor to begin with from a very creditable organization. We are quite comfortable with the rig as it is.

**Joy Wang from Deutsche Bank in Singapore:** Keppel Land's divestment is more than investment in 2016. Will we see increase in investments in 2017? What is the market and sector of focus in 2017?

**LCH:** I will answer the first question and let Wee Gee answer the second part of the question. I suppose we do not have any specific target in terms of investing. It very much depends on the opportunities that come up. We are obviously very focused on making sure that all of our asset heavy businesses such as Keppel Land, produce good return on capital employed not just at project level but property book level. There are several markets that Keppel Land is looking at, and Wee Gee will take that question.

**AWG:** We will continue to focus on core markets of Singapore and China, and growth markets of Vietnam and Indonesia. As a foreign developer, it is very challenging to compete in overseas markets and we believe that after investing overseas for many years, that it is important to focus and scale up in cities of focus. Even within countries we will be focusing on certain cities. For China we will be focusing on Shanghai, Beijing, Wuxi, Chengdu and Tianjin. For Vietnam, mainly Ho Chi Minh City, and perhaps Hanoi when there is a right opportunity. For Indonesia, Jakarta or Greater Jakarta. We think that this is the right strategy moving forward. We will also keep an open mind on other markets. There will be markets that we will invest in opportunistically. We will look into other sectors as well, but the sector of main focus would be residential, lifestyle residential, townships, commercial, office and mixed-use developments.

**Joy Wang from Deutsche Bank in Singapore:** Keppel Capital has been very active. Will we see any promote fees on top of current base fees for any of the funds?

**Christina Tan:** I don't think we breakdown our fees into promote fees and base fees. All promote fees earned will be recognised in the profit and loss.

**LCH:** So that is a yes. If your funds continue to perform well, you should see performance fees.

**Cheryl Lee from UBS:** Regarding your dividends, could we get some comments on how you arrive at your decision of a total dividend of 20 cents? Do you think this is sustainable in absolute terms?

**LCH:** That is a good question, and you have always asked us questions on dividends. This is fair, because a lot of our shareholders of Keppel are income funds, so they look at dividend as a very important part of the total returns. This is also something that the Board of Keppel Corp is very well aware of. When we decide the total dividend for the whole year, we consider several factors. The first factor is that it is a sharing. We have always said that when we do well, we want to share with our stakeholders. In that regard, we don't have an explicit policy, but you can see from the recent dividend that we have set is somewhere between 40-50% of our net profits for the year. At 20 cents this year, it is about 46%, slightly higher than the mid-range. The second factor is to make sure that whatever dividend we set is what we believe is sustainable. On that basis we are comfortable in recommending to our shareholders a final dividend of 12 cents, which will then make it 20 cents for the whole year.

**Cheryl Lee from UBS:** is it sustainable in absolute terms?

**LCH:** Based on what we see today, this is something we can afford to pay. Of course, the conditions this year and next year may change. We will make the evaluation when we come to the same period next year, and it will depend on the Group's capital requirements and the market at that point in time.

**Conrad Werner from Macquarie:** Did you quote a clean net income number at the very beginning when you were introducing financials for the fourth quarter? In other words, the reported number was \$143 million, did you quote a clean normalised number?

**LCH:** I think I said in paragraph 12 in my speech that in the fourth quarter the net profit was \$143 million. However, if we stripped out RID and major provisions, the net profit of \$300 million is comparable with that of 4Q2015.

**Conrad Werner from Macquarie:** Sure. So what you are adding back is the provisions and taking out some of the one-off gains as well?

**LCH:** What we are trying to say is the fourth quarters for 2016 and 2015 are very much impacted by the RIDs. If you strip out the impairment, revaluation and divestment gains for both the fourth quarters of 2015 and 2016 it would be on a comparable basis.

**Conrad Werner from Macquarie:** So for example the \$60 million that was quoted in the Property division for the Mandalay project...

**CHC:** Two projects actually, the Sedona Yangon and Sedona Mandalay.

**Conrad Werner from Macquarie:** So you would start with 143, add back the provisions but subtract something like that?

**CHC:** Yes.

**– END of Q&A session –**