RESULTS UPDATE

Diversified ▪ Singapore

KGI CHINA DEVELOPMENT FINANCIAL

Keppel Corporation Ltd

(KEP SP/KPLM.SI)

Muted outlook as key segments face headwinds

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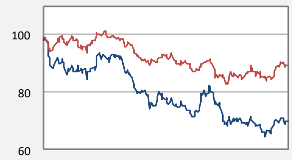
- 4Q18 PATMI returned to profitability of S$135mn vs a loss of S$492mn in 4Q17. Stripping out the one-off fines in the prior year period, 4Q18 EPS increased 7% YoY.
- KEP declared a final dividend of 15 SG cents, 1 cents higher YoY, bringing FY18 full year dividend to 30 cents vs 22 cents in FY17. Dividend yield is once again at a level similar to pre-oil price crash in 2014.
- Although KEP delivered a good set of results, we downgrade KEP to HOLD given our defensive theme in 2019. Earnings growth across our equities coverage may have likely peaked in 2018 and we do not see an attractive risk-reward for cyclical stocks in the next 6-12 months. Our preference would be for income stocks with stable cash flows.

HOLD - Downgrade

Price as of 28 Jan 19 (SGD)	6.17	**Performance (Absolute)**	
12M TP ($)	7.50	1 Month (%)	4.6
Previous TP ($)	9.43	3 Month (%)	-0.2
Upside, inl div (%)	26.4	12 Month (%)	-25.7
Trading data		**Perf. vs STI Index (Red)**	
Mkt Cap ($mn)	11,183		
Issued Shares (mn)	1,812		
Vol - 3M Daily avg (mn)	3.1		
Val - 3M Daily avg ($mn)	18.9		
Free Float (%)	79.4%		
Major Shareholders		**Previous Recommendations**	
Temasek	20.5%	27-Sep-18	BUY $9.43
Blackrock	4.9%	23-Apr-18	BUY $9.43
Vanguard	2.2%	15-Dec-17	BUY $8.67



Financials & Key Operating Statistics

YE Dec (S$ m)	2017	2018	2019F	2020F	2021F
Revenue	5963.8	5964.8	5885.4	6388.7	6892.0
PATMI	216.7	943.8	1061.6	1104.5	1169.0
Core PATMI	815.5	933.8	1061.6	1104.5	1169.0
Core EPS	44.9	51.5	58.5	60.9	64.4
Core EPS grth (%)	6.1	14.7	13.7	4.0	5.8
Core P/E (x)	13.7	12.0	10.5	10.1	9.6
DPS (SG cents)	22.0	30.0	30.0	32.0	34.0
Div Yield (%)	3.6	4.9	4.9	5.2	5.5
Net Margin (%)	3.6	15.8	18.0	17.3	17.0
Gearing (%)	44.5	46.9	48.8	42.0	34.6
Price / Book (x)	1.0	1.0	0.9	0.9	0.8
ROE (%)	1.8	8.1	8.3	8.3	8.4

Source: Company Data, KGI Research

Post-briefing analysis. Key points from the results briefing with management: 1) Improvement across 3 out of 4 business segments, 2) Increase in DPU p.a. since 2016, when it bottomed at 20 cents, 3) excluding one-off expenses, 4Q18 EPS improved 7% YoY to 7.4 cents, and 4) outlook across O&M and property businesses looks muted, in our view.

Overall a good set of results. KEP's diversified business was evident in FY18's results, as we saw both its property and infrastructure segments contribute most of its full-year earnings growth, which more than offset weak (but improving) performance at its O&M business and provisions under its Investment segment.

Property segment headwinds. China's slowest GDP growth since 1990 is expected to weigh on the country's property sector going forward. Already, growth in China's property investment in December declined to its second slowest pace in 2018, reflecting the impact of the cooling measures and slower economic growth. Given that Singapore and China's home sales contributed 70% of total home sales of KEP – and that both still have cooling measures in place – this segment may potentially surprise on the downside.

O&M slow recovery; more Sete provisions. Net orderbook (excluding Sete Brasil orders) increased to S$4.3bn as at end-2018 compared to S$3.9bn as at end-2017. However, O&M segment outlook looks muted in 2019 and 2020 as competition in the newbuild space remains high. As such, we do not factor in a meaningful contribution from its O&M segment until 2021, a view reinforced by management where they do not expect a V-shaped recovery. There was an additional S$167mn provision for the Semis for Sete Brasil, which surprised us as we had thought previous provisions of around S$300mn was sufficient.

Valuation & Action

Challenging outlook; downgrade to HOLD. We downgrade our recommendation to HOLD, driven mainly by the growth slowdown in its key markets and our cautious macro views. KEP's 5% dividend yields (based on historical average of 50% payout ratio) should provide downside support, but upside is also limited, and thus does not provide an attractive risk-reward in the next 6-12 months. Our preference would be for income stocks with stable operations, such as Keppel DC REIT (KDCREIT SP, Not-rated).

Our fair value is based on SOTP valuation of its businesses and mainly driven by property (50% of valuation), O&M (20%) and Keppel Capital (15%). These three businesses contribute 85% of our fair value estimates of the group. KEP's track record of unlocking value via divestments may provide further upside to our earnings and dividends forecasts.

Risks

KEP's property segment now contributes the largest share of profits. As a result, a slowdown in the property sector in its key markets like China and Singapore will have the largest impact on KEP's valuations.

Figure 1: SOTP Valuation

	Stake (%)	Valuation Method	Value (S$m)	Keppel's Share (S$m)	Per Share (S$)	% of total value
Offshore & Marine						
Offshore & Marine	100%	1x FY19F P/B	2,905	2,905	1.59	21%
Property						
Property	100%	0.8x FY19F P/B	7,179	7,179	3.94	52%
Infrastructure						
Keppel T&T	80%	Market price	1,051	841	0.46	6%
Keppel Infrastructure Trust	18%	Market price	2,006	365	0.20	3%
Investments						
Keppel Capital	100%	20x FY19F P/E	1,400	1,400	0.77	10%
KrisEnergy	38%	Market price	128	48	0.03	0.4%
Dyna-Mac	25%	Market price	107	27	0.01	0.2%
Tianjin eco-city	45%	Discounted surplus	920	920	0.50	6.7%
Total Value (S$m)				**13,685**	**7.51**	
Shares (m)				1,825		
Value per share (S$m)				7.50		
Current price				6.21		
Upside/(downside)				20.8%		
Dividend yield (%)				4.83%		
Total returns (%)				25.6%		

Source: Company data, KGI Research

Valuations. While our fair value implies a total return of 26%, including dividends, we believe the risk-reward over the next 6-12 months just not justify recommending investors enter into cyclical stocks at this point.

Significant changes. Major changes to our SOTP valuation were driven by the significant capital injection into Keppel O&M, where its NAV increased to S$2.9bn as at end-2018 compared to S$1.2bn as at end-2018. For Keppel Land, we downgraded our valuation multiple to 0.8x P/B to better reflect the weak outlook for its property segment in China and Singapore.

Our China macro analyst highlights that China's easing of policy measures will likely not translate into a meaningful rebound as the government will be focused on stability rather than stimulus.

In Singapore, home loan growth slowed to 1.9% in Jan-Nov 2018, which was half the 4.2% recorded in 2017, according to data by the MAS. Private residential home prices declined for the first time in 6 quarters in 4Q18 after new cooling measures were announced in July 2018. The government has stated that it will not take a hands-off approach to the property cycle and emphasised the government's aim is to have a sustained property market where prices move in line with fundamentals or income growth.

KGI's Ratings

Rating	Definition
	KGI Securities Research's recommendations are based on an Absolute Return rating system.
BUY	>10% total return over the next 12 months
HOLD	-10% to +10% total return over the next 12 months
SELL	<-10% total return over the next 12 months

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