KGI CHINA DEVELOPMENT FINANCIAL

Keppel Corporation Ltd

(KEP SP/KPLM.SI)

Weak first half while outlook looks muted

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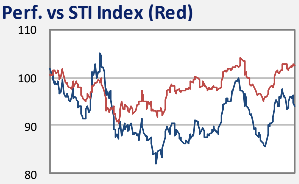
- KEP reported a 38% YoY decline in 2Q19 PATMI to S$153mn due to the absence of en-bloc sales of property projects that contributed in the prior-year period.
- KEP declared an interim dividend of 8 SG cents, which was 2 cents lower than the 10 SG cents ordinary dividend declared in 1H18 (1H18 total interim was 15 SG cents, which included a 5 SG cents special dividend).
- We maintain our NEUTRAL recommendation given the weak macro outlook and the lack of short-term catalysts. 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.

NEUTRAL - Maintain

Price as of 19 Jul 19 (SGD)	6.57	**Performance (Absolute)**	
12M TP ($)	7.43	1 Month (%)	0.5
Previous TP ($)	7.50	3 Month (%)	-0.1
Upside, inl div (%)	16.7	12 Month (%)	-1.9
Trading data		**Perf. vs STI Index (Red)**	
Mkt Cap ($mn)	11,884		
Issued Shares (mn)	1,817		
Vol - 3M Daily avg (mn)	3.5		
Val - 3M Daily avg ($mn)	22.7		
Free Float (%)	78.7%		
Major Shareholders		**Previous Recommendations**	
Temasek	20.5%	28-Jan-19	N $7.50
Blackrock	4.9%	27-Sep-18	OW $9.43
Vanguard	2.2%	23-Apr-18	OW $9.43



Financials & Key Operating Statistics

YE Dec (S$ m)	2017	2018	2019F	2020F	2021F
Revenue	5963.8	5964.8	6390.6	6896.2	7401.8
PATMI	216.7	943.8	826.2	1108.9	1170.7
Core PATMI	815.5	933.8	826.2	1108.9	1170.7
Core EPS	44.9	51.5	45.5	61.1	64.5
Core EPS grth (%)	6.1	14.7	-11.5	34.2	5.6
Core P/E (x)	14.6	12.8	14.4	10.7	10.2
DPS (SG cents)	22.0	30.0	24.0	26.0	30.0
Div Yield (%)	3.3	4.6	3.7	4.0	4.6
Net Margin (%)	3.6	15.8	12.9	16.1	15.8
Gearing (%)	44.5	46.9	73.8	62.8	54.1
Price / Book (x)	1.0	1.1	1.0	0.9	0.9
ROE (%)	1.8	8.1	6.5	8.3	8.3

Source: Company Data, KGI Research

2Q19 summary. The 38% YoY overall decline in 2Q19 earnings to S$153mn was driven mainly by a 38% YoY decline in its property segment earnings to S$130mn and a S$24mn loss in its investments division. This was offset by the return to slight profitability by its O&M segment and 8% YoY earnings growth to S$43mn from its infrastructure segment.

Time to digest. Given that KEP's current 0.8x net gearing - almost double from last year - is near the 1.0x limit that it has set as an internal target, management will be busy focusing on extracting synergies from its recent privatisations of M1 and Keppel Telecommunications & Transportation. Although there are some short-term visible results - such as with M1 increasing its customer base by 80,000 YoY as at end-June 2019 with a revamp of its offering and simplified plans – we think that any significant earnings contribution from potential synergies will only be clearly visible over the next few years.

Property segment headwinds. KEP's property segment contributed to around 70% of its 1H19 PATMI, with sales in China and Singapore accounting for a significant portion of those earnings. Outlook for the property sectors remains muted, with risks on the downside, given that both countries still have tight property cooling measures in place. Hopes for a property rebound in China may be premature as regulators seem intent to keep property controls in place while the central bank continues to keep mortgage rates high.

O&M recovery but margins still weak. Net orderbook (excluding Sete Brasil orders) increased to S$5.5bn as at end-June 2019 compared to S$4.3bn as at end-2018. However, O&M's operating margins is expected to remain low in 2019 and 2020 on the back of intense competition for projects. As such, we do not factor in a meaningful earnings contribution from its O&M segment until 2021, a view reinforced by management.

Valuation & Action: Challenging outlook; maintain NEUTRAL. We maintain our NEUTRAL recommendation as we continue to see a challenging outlook for its key business segments in the next 6-12 months. We were rather disappointed that KEP did not maintain the 10 SG cents interim dividend this year, but we understand management's decision given the lower performance in 1H19 and the need to remain prudent in the face of an uncertain macro environment. A better than expected performance in 2H19 may possibly see an increase in its final dividend payout.

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 (10%). These three businesses contribute 80% 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$)	% of total value
Offshore & Marine						
Offshore & Marine	100%	1x FY19F P/B	2,600	2,600	1.43	19%
Property						
Property	100%	0.8x FY19F P/B	7,179	7,179	3.94	53%
Infrastructure						
Keppel Infrastructure Trust	18%	Market price	2,522	459	0.25	3%
Other Infra assets (e.g., Kep T&T)	100%	10x FY19F P/E	1,300	1,300	0.71	10%
Investments						
Keppel Capital	100%	15x FY19F P/E	1,050	1,050	0.58	8%
KrisEnergy	38%	Market price	56	21	0.01	0.2%
Dyna-Mac	25%	Market price	118	30	0.02	0.2%
Tianjin eco-city	45%	Discounted surplus	920	920	0.50	6.8%
Total Value (S$m)				**13,559**	**7.44**	
Shares (m)				1,825		
Value per share (S$m)				7.43		
Current price				6.57		
Upside/(downside)				13.1%		
Dividend yield (%)				3.65%		
Total returns (%)				16.7%		

Source: Company data, KGI Research

Valuations. While our fair value implies a total return of 17%, including dividends, we believe that the risk-reward over the next 6-12 months does not justify recommending investors to enter into cyclical stocks at this point.

Changes to our valuations. Changes to our SOTP valuation were driven by the privatisation of M1 and Keppel Telecommunication & Transportation.

For Keppel Land, we maintain 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 monetary policy measures will likely not translate into a meaningful rebound as the government will be focused on stability rather than stimulus.

In Singapore, the government has stated that it will not take a hands-off approach to the property cycle and emphasised the government's aim to have a sustained property market where prices move in line with fundamentals or income growth.

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Rating	Definition
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Neutral (N)	We take a neutral view on the stock. The stock is expected to perform in line with the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
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