Keppel Corporation 2Q & 1H 2015 Results Announcement

Question & Answer Session

23 July 2015, 5:30PM

Panellists:

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
OTG	Ong Tiong Guan, CEO of Keppel Infrastructure
AWG	Ang Wee Gee, CEO of Keppel Land

Xin Jin from Morgan Stanley: Given there is a potential that your orderbook will see a decline if you are not replenishing as fast as you are recognising your revenue, what are the options or initiatives you can take to lower costs at Keppel O&M?

LCH: The yards are still very busy for the next two years. We have a very sizeable orderbook to execute. We also have to respond and get ready for market conditions ahead. The team led by YY is looking very closely at all our costs. After ten years of very good growth, this is also a good period for us to consolidate and look at how we can continue to improve on cost efficiency.

Xin Jin: The second question is on the Infrastructure Division. Will you be able to elaborate on the finalisation cost for the work in Doha? If I do a simple calculation, it would look as if for the second quarter, the Infrastructure Division actually registered a loss to close to $160 million.

CHC: You would have seen in the presentation slides earlier that in the second quarter, the Infrastructure Division's net profit was higher by $67 million. That has a number of lumpy items in there. During the quarter, we also divested 51% interest in Keppel Merlimau Cogen to Keppel Infrastructure Trust (KIT). As Chin Hua has mentioned, that actually provided a gain of $202 million.

The combination of KIT with CitySpring also resulted in a gain of over $60 million. So in total, it was about $260 million of gains arising from these two related transactions. That was partially offset by additional losses that we have taken as a result of the finalisation of costs to complete (Doha North) which was roughly under $200 million. We believe that this should be the final round of adjustments we need to make for the Doha North project. With this, the three EPC projects would be behind us. We would have taken up all the losses arising from costs to complete for all these three projects.

Abhijit Attavar from Jefferies: Can you please indicate the rough contributions of the Sete Brasil projects to the total revenue recognised by the Offshore & Marine Division in the second quarter of 2015? Is Keppel continuing to execute these projects given that Sete Brasil's debt restructuring is not yet complete? Have you received any progress payment from Sete Brasil in the second quarter of 2015? As of now, is the payment from Sete Brasil still ahead of work-in-progress on book?

LCH: As we have reported, we have not received payments since November last year for these projects. Sete is still going through their financial restructuring. As at end of the second quarter, we had a very small net cash outflow for all the projects with them, these are the six semis.

On the second question, we have also shared before that we are slowing down on construction. We are in active discussion with Sete. It is very clear to us that Sete and the end user Petrobras, need all the six rigs, and they are working with us to see how these rigs can be delivered. On our part, we have to wait for their restructuring to be completed.

CHC: As Chin Hua has mentioned, we have already started to moderate the progress of Sete's semis. As for the progress on the three semis, the first one is now 90% completed. You may recall from our last results update that it was 89% completed at that point in time. The second one is now at 63% completion while during the last quarter, it was at 58%. And the third one is now 36% completed and was 32% during the last quarter. You can see that the progress has been moderated, so the contribution coming from Sete Brasil is actually quite small.

Gerald from Credit Suisse: Would you consider financing the construction of some of the rigs if asked by Sete Brasil?

LCH: This has been reported by the media, and I think you are quoting from one of them. We are discussing with Sete on how best to finance the fifth and sixth rig. We have to look carefully at this and make sure that any terms of change have to make sense for both sides.

Gerald from Credit Suisse: My second question is on the recurring income chart you have shown – is there a target on how much you intend to grow the incurring income by over the next few years?

LCH: We expect recurring income to grow. We have an internal target but that will depend on market conditions. We won't be sharing that target.

Gerald from Credit Suisse: Lastly, for the Property Division, the net profit actually increase between the first and second quarter. Was that driven more by profit contribution in Singapore or in China?

CHC: As we have mentioned in the presentation, we had more contributions from China this quarter as there was completion of projects in China. As you know, the property revenue and profit in China are recognised on completion. That is one reason. Also, there was higher sales of residential units in China.

Alejandra from IHS Petrodata: You mentioned that 10 jackups will be delivered during the second half of 2015. Are there any delays expected for any of these as a number of them do not have contracts on hand? My second question is are there any options being exercised by Ensco or GDI, if these still exist.

CYY: In the early part of this year, we had announced that there had been some shift in deliveries, so that has already been taken into account when we say that 10 rigs are due for delivery in the second half of 2015, and there has been no request for further delay for these rigs. Our projects are also doing quite well, being on time and on budget. The GDI options are still on. No one has exercised any options at this point in time.

Alejandra from IHS Petrodata: For the drillship, can I know if the tentative delivery date is still 2016?

CYY: We have built the drillship on our own account, so we can be quite flexible. Based on the current market condition, we together with our Japanese subcontractor have decided that we can slow down. So instead of delivery in end 2016 as we have announced earlier, we have pushed it back to the second quarter of 2017. Having said that, we are still actively marketing the drillship. We still believe that this drillship is a differentiating product and that there will be demand. If someone comes to us and says that they need an earlier delivery, we can meet that requirement. We are quite flexible in that sense.

Nancy Wei from UOB: You said that the yard will still be busy this year based on your orderbook, but the numbers say otherwise because they are falling. I am wondering for next year, are we going to see a sharp decline in the earnings?

CYY: We have to look at all the three business divisions. For the Offshore Division, we are delivering 15 rigs this year, so we are quite busy. Next year, we will have about 8 rig deliveries, and in the year after about 6.

In the meantime, we are busy with a lot of repairs. Of course, while the profit margin is higher for repairs, the revenue is lower. For Keppel Shipyard, even though there has been a slowdown in FPSO contracts, the trend shows that they may be coming back. On top of that, there are the FLNG conversion projects that we are working on right now. Keppel Singmarine is actually hiring more people because revenue from its part of the business is expected to grow by more than 60% from the previous year.

But you are right, revenue will be lower. However, we are taking this opportunity to right size the organisation. During the process, there will be a natural attrition of workers who are near retirement, while at the same time, we have subcontractors who can help with the adjustment.

Nancy Wei from UOB: Does the Group have a target on what you want to realise in cost savings for the offshore and marine business because other companies we talked to have some figures that they want to work towards.

CYY: We do not really have a figure. What I can say is that we have not rested on our laurels. For optimal operations, we have considered what would be the right size for overheads, workforce and so on, and have been doing some trimming. On top of that, we are executing a lot of productivity improvements, and have continued to invest in R&D.

I have said before that we must not waste this crisis, and this is exactly what we are trying to do. There is also a lot we can do with the supply chain. In fact, in this market, a lot of the equipment and material costs have come down, so these also present opportunities for us.

LCH: When we talk about right-sizing, we are also doing what I call value engineering, which is not just cutting costs across the board. We are still investing in R&D and training, and improving on our productivity. Certainly, there are areas where we can tighten up. The main things are to ensure that our overheads are well under control and that we are ready if the market conditions get tougher so that we can continue to make a profit.

Peter Gylfe from Balyasny: Can you discuss your first FLNG conversion with Golar, how is that progressing relative to plan and budget?

LCH: It is performing according to plan and budget, so that is something we are quite happy with. We are tracking the project very closely.

Peter Gylfe from Balyasny: What does the runway with Golar on FLNG contracts look like going forward? If we fast forward five years, is it possible that you would have built 10 FLNG facilities for Golar by that point?

LCH: We hope so but we are not making projections here. The key thing is: FLNG is a growth market and people still expect investments to go into this area. With three FLNG conversions, we are a first mover with Golar and other partners, and we hope to do more in this area.

CYY: The first FLNG conversion for Golar, the Hilli, is doing quite well, and I am pleased to inform that we are on budget and on schedule. As for the opportunity with Golar in the next five years, the arrangement is that there is one FLNG facility to be delivered to Golar per year – 2017, 2018, and 2019. While I cannot foresee what the market is like, at least according to the trend, there is a very sizeable budget for the FLNG business. We have some very active enquires from parties other than Golar, so it suffices to say that we are quite optimistic about that segment of our business.

Goh Eng Yeow from Straits Times: For the second quarter this year, staff costs came down 17.5%. Is there a reason why staff cost came down so sharply?

CHC: We pay for performance. We have fixed and variable components in our remuneration, so the bonus part is pegged to performance. With the results, there is some reduction in the provision for the variable component.

LCH: But it does not mean we have cut our workforce by 17%.

Goh Eng Yeow from Straits Times: When you say you are right-sizing your operations, does that mean there will be job redundancy in Singapore?

LCH: Let’s put it this way, as we have to meet the foreign workers quota over the next few years, this is something we have been planning already. This is with reference to the offshore and marine business. We have in the last couple of years started to upgrade our regional yards, which is part of our process to improve productivity. Some of the work which we can’t do in Singapore, we will be shifting to our overseas yards.

CYY: Over the last couple of years, we have been looking at how to increase our production capability. That is why we have invested in our overseas facilities. I am pleased to tell you we are on target to meet the (Singapore) government's foreign workers quota. The government has actually forced the pace of that change, in fact by 2018, our quota will be 3.5 to 1.

Cheryl from UBS: I have a few questions. The first question is on the infrastructure division. We know that you sold the 51% stake in KMC, however, you still have an exposure to the electricity market via your retail business. So could we have some sense on how that side of the business performed in the second quarter, and also the outlook? The second question is on property. Can we just clarify the basis for the $18 million savings you mentioned on interest expense on the Keppel Land privatisation? Just to clarify whether this takes into consideration the $3 billion that you would have paid.

OTG: Although we divested 51% of KMC, it doesn't mean that we are out of the generation business. We continue to be exposed to the commercial part of the business, and we continue to keep the gas business, that's why we have the power integration. And this will go on for some time. I think we plan to continue to stay and grow the business. For the Singapore business, as you are familiar, margin compression is showing up quite fast and business margins will be challenged over the next few quarters. Particularly in 2016, I think the pressure will be higher. As for 2015, I think we are still managing it quite well.

LCH: On the $18 million interest savings, just to elaborate, I was referring to the existing loan book from Keppel Land. Over time, if you were to refinance it based on Keppel Corp's credits that will lead to about $18 million savings in interest a year. Not all of it is actually interest because when we use the funds to privatise the Keppel Land, some of these funds are actually cash in our balance sheet. Even though it is cash, over time if we use the cash our net gearing will actually go up. All the interest is already factored into the numbers that you see.

Ajay from J P Morgan: On Sete Brasil, can you update us on delivery dates for the six semis; if there has been any change in that regard? The second question is on gearing, does the management expect to normalise on current levels of 0.4 to 0.5 times?

CYY: On the Sete semis, as you know they have not paid us since November last year, so we have been engaging in discussion with them. What we basically told them is that with payment resumption, there will be a little bit of time for us to reactivate. So you can see that we have continued work on a slower pace. I will say that there is some discussion between Sete and ourselves on the new delivery date. There would be a ten-months delay in payment but because we have slowed down, the corresponding shift in delivery date will probably be less than ten months. And that is the same for the rest of the units. Because there is a ten-month interval between every unit, there will be a domino effect.

CHC: I'll take the second question on gearing. For gearing, it's not meaningful to look at a single point or a narrow band at 40% or 50%. At the end of the day, as we deploy capital, as we allocate capital in the Group, we want to make sure that we don't over extend our balance sheet, we want to still maintain an institutional quality balance sheet. That's an important operating principal. So in that regard, it will be very unlikely for us to have our gearing exceed one time, for example.

Cheryl from UBS: A follow up question on Sete Brasil, could we get a sense of how much of capex has been spent in the year, in that area in Keppel's books in the last ten years? There will be, I mean, at the end of the day, financial costs related to having a lower level of revenues spread across your fixed costs and so on, so could you give a sense of the financial impact?

LCH: We have been quite careful in spending money, not just in Brazil but in all our yards. Actually the yard that you are referring to in Angra, it was a bankrupt yard which we had bought. It is a yard that's leased. We are quite careful that we don't over invest, but in the last few years, we have invested for instance in a heavier crane and this has helped in terms of efficiencies. But this is nowhere near the kind of capital required to build a new yard. As you know others have to build new yards in Brazil, so that's something that we didn't have to do.

Tomomi from Nikkei: Could I get your view on how rig orders have been globally for this year? In the last press conference, you said that you hadn't seen much activity in that, so whether the situation has changed? On residential sales, China constitutes 63% so far, do you see that ratio changing in the future? For example, given the number of properties lined up in China, do you see a change in the percentage of China's residential properties going up or down? How do you view the Chinese residential market, the possibility of it crashing, for example?

LCH: The headwinds are very tough in market for drilling rigs right now. I think for the year, as far as we know, there have been only three rigs ordered, one in a close market in the Middle East and two in China. The two in China we believe are of a related party, so it's not exactly representative of demand in our opinion. So it's going to be quite tough. But I think one has to kind of take a step back and realise that we've gone through a period of tremendous growth in the offshore market, and this downturn is not totally unexpected. As I mentioned in my speech, there are things that are happening - retirement of old rigs for example, scrapping of old rigs that would position the market for growth in the future.

AWG: Regarding the Chinese residential market, we are quite positive on the market, in the coming one to two years. We see the market recovering with the government lifting of the cooling measures. In the banking sector, we have seen the government cutting the interest rate three times this year, so lowering the bank reserve ratio. In China, there's the phenomenon of urbanisation and growing middle income. And there's a real fundamental need for housing. In the last few years, the market was slower and that created pent-up demand. So we see demand coming back and we see the proportion of contribution from our china residential business growing in the next few years.

Ke Yan from Smart Karma : The progress in deep sea mining is very encouraging – could you elaborate more on your deep sea mining? How much is the estimated investment in this sector, and what is the time frame?

LCH: The time frame is expected to be quite long. This is a very exciting project for Keppel. Besides the actual investment in this, we are also looking to develop new technologies with Ocean Mineral that can allow us to do this activity on a sustainable basis. On the estimated investment, we are taking it one step at a time. It doesn't mean that we will have to fund everything ourselves. Over time, we can also partner with others, to exploit this. At Keppel, we are always very disciplined when looking at investments, and also the risks. Before we take every step in this project, we will be careful to make sure that the sums still make sense.

Mohammad Razali, retail investor: What is the progress on Keppel's Heads of Agreement with PETRONAS on the import of LNG? How about the progress with PEMEX on the progress of six new jack ups?

OTG: Our Heads of Agreement with PETRONAS is subject to us winning the license, so we will have to put it on hold for the time being. But we will continue to discuss with PETRONAS for our future imports of both LNG and pipe gas.

CYY: On the second question with PEMEX, negotiation is still on going and we will make an announcement when it is finalised.

Abhijit Attavar from Jefferies: Is your dividend pay-out policy based on total reported profits including the gains on Keppel Merlimau, or would you be looking at project-based profits?

LCH : I think the key here is that we look at our RIDs as part and parcel of our earnings, so it is available to us in terms of funding dividend pay-outs.

Goh Eng Yeow from Straits Times: Some analysts report that this slump resembles that of 1985. What is your take on it and the rig building industry?

CYY: Personally I have gone through four cycles. I think it is too early to say, because there are so many factors. You have shale oil, you have Iran coming out. The world economy is not on the growth path that will increase demand too much, but even so, demand will probably go up by 1.5% or .4% on a daily basis.

Like what Chin Hua said – we have had a good ten-year run. It's not necessarily something that we didn't foresee, but I think it's more the speed of it that we have to manage. We will take this time to consolidate. I'm quite sure the market will come back up again. After every downturn, Keppel has always come up stronger. So I think we will take this opportunity to strengthen our operations, strengthen our businesses and get ready for the upturn.

<End of Q&A session>