

SECTOR UPDATE

Offshore & Marine – Singapore

KOM And SMM Merger: A Simpler Transaction

KEP and SMM announced the variance of their merger terms, thus making it simpler and faster to complete. Our view remains that the combination of KEP's offshore marine segment and SMM benefits both in the short and long term. For KEP, the divestment of KOM will allow it to focus more on asset-light and/or recurring-fee businesses while SMM will become a larger and arguably more competitive entity with a strong renewables focus. Maintain BUY ratings on both KEP and SMM.

- A simpler and faster transaction.** Keppel (KEP) and Sembcorp Marine (SMM) announced that they have varied the terms of the merger that was previously announced in Apr 22. Instead of merging with KOM under a new company, SMM will now acquire KOM with the consideration being the issuance of new SMM shares. The benefit of this new method is that it is simpler given that it does not require lengthy court approvals, nor does it require SMM to transfer its listing status to a new holding company. Importantly, the equity value exchange ratio has been amended slightly from 44:56 for SMM:KEP to 46:54. This has resulted in the consideration for KOM being reduced by 7.8% to S\$4,495m (see table on RHS).
- Impact to SMM shareholders:** For SMM shareholders, they will undergo less dilution vs the previous method as the price for KOM has been lowered. Overall, the transaction is simpler in nature given that it is exposed to a single business line and is a pure-play on the offshore marine construction industry.
- Impact to KEP shareholders:** While the consideration for KOM has been lowered, KEP shareholders will receive a larger amount of shares worth S\$2.33 vs S\$2.26 previously. Importantly, KEP has managed to positively modify the terms of the Vendor Notes that will be issued by the Asset Co. Recall that as part of the merger with SMM, KEP had linked the sale of legacy oil rigs and associated receivables into a separate entity called Asset Co to be owned by a third-party investor comprising of Baluran Limited (74.9%), Temasek's wholly-owned Kyanite (15.1%) and KEP (10%). Part of the Asset Co consideration was via 10-year fixed-rate notes with a 2% p.a. coupon, which has now been re-negotiated up to a 4% p.a. coupon instead. Additionally, the sale of KOM has been de-linked to the divestment of Asset Co which at least ensures the success of the latter.
- What the new SMM will look like.** In just short six months since this transaction was first announced in Apr 22, it has dramatically improved in quality. In Apr 22, the combined entity reported a net orderbook of S\$6.4b as at end-21 and this has risen nearly 3x to >S\$18b. Both KEP and SMM have announced a number of large and exciting new order wins in 2022. The merged entity will have over 30 projects under execution in three broad silos: offshore renewables, new energy (eg floating carbon capture storage and ammonia carriers) and cleaner offshore marine solutions. What has not changed is the creation of a new global player in the above three silos which will capture the strong order momentum in offshore wind farms and new energy sources like hydrogen.
- KEP reported a strong 3Q22 business update.** In a separate announcement, KEP reported a strong 3Q22 business update with revenue rising 24% yoy to S\$6.8b and above our expectations. While the company did not disclose net profit numbers for 3Q22, it did state that net profit was lower yoy due to the high base effect of lumpy en bloc sales which boosted 3Q21 profits. The two key segments that performed well were energy & environment and asset management while, as expected, the management sounded bearish on its China property business. We maintain our BUY rating on KEP and a target price of S\$10.11. Given the relatively more complex nature of the transaction, it may take time for the value of the merger to be realised. In addition, we note that KEP estimates that the monetisation timetable for Asset Co will be between 3-5 years.

FOCUS STOCKS

Company	Rec	Price (S\$)		Up/down (%)
		27 Oct	Target	
Keppel	BUY	6.65	10.11	52.0
Semb Marine	BUY	0.122	0.156	27.9

Source: Bloomberg, UOB Kay Hian

NEW VS OLD TERMS

Item	Old terms	New terms
Equity value exchange ratio (SMM:KOM)	44:56	46:54
Issue price for SMM shares	S\$0.122	S\$0.122
Shares issued to KEP by SMM	39.950b	36.848b
KOM consideration	S\$4,874m	S\$4,495m
Distribution in specie to each KEP shareholder (no. of shares)	18.5 ¹	19.1 ²
Value of shares received by each KEP shareholder	S\$2.26/shr	S\$2.33/shr

Note: ¹ Based on 1,771.0m KEP shares on issue (excl. treasury shares); ² Based on 1,751.9m KEP shares on issue (excl. treasury shares)

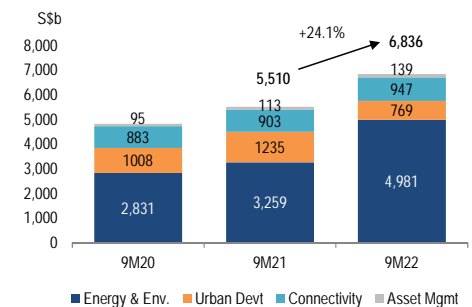
Source: SMM, KEP

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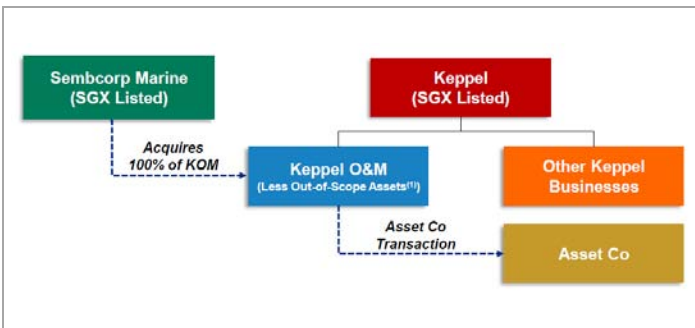
- We maintain our **BUY** rating on **SMM** with a target price of **S\$0.156**. With these new merger terms in place, and on the back of nearly S\$6.9b of new orders in 2022, we believe that the company is well placed to return to profitability in 2023. In our view, the offshore construction cycle for both conventional oil and gas and renewables has room for growth in the next few years, especially given the lack of spending by the global oil and gas industry which constrains energy supply. The risk to our thesis is for restrained capex spending despite oil and gas prices being at elevated levels, with energy companies returning cash to shareholders via dividends or share buy-backs.

KEP REVENUE COMPARISON: 9M22 VS 9M21



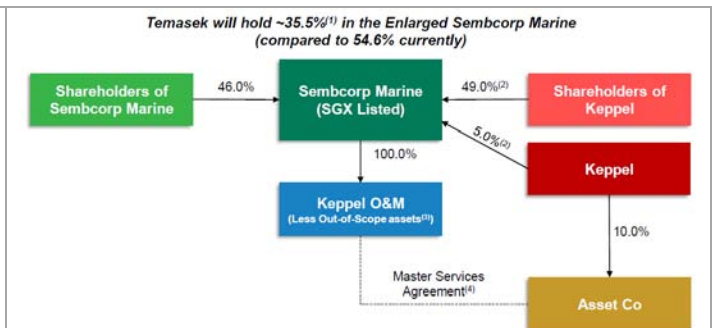
Source: KEP

A SIMPLIFIED TRANSACTION STRUCTURE



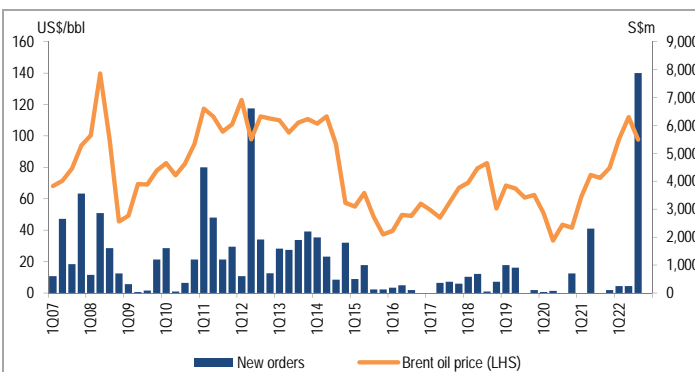
Source: SMM

POST ACQUISITION STRUCTURE AND OWNERSHIP



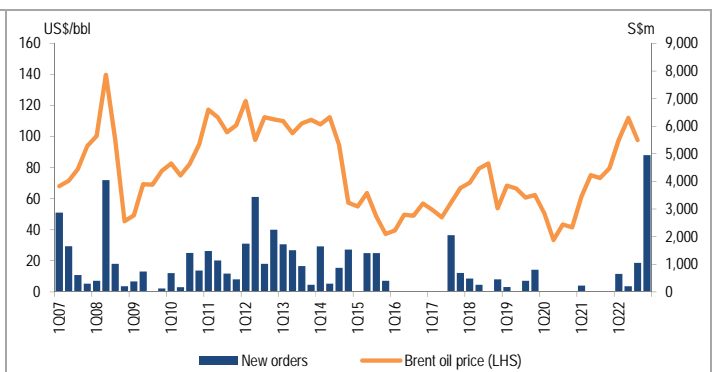
Source: SMM

KEP'S NEW ORDER WINS BY QUARTER VS BRENT OIL PRICE



Source: KEP, UOB Kay Hian

SMM'S ORDER WINS BY QUARTER VS BRENT OIL PRICE



Source: SMM, UOB Kay Hian

OVERVIEW OF THE MERGER

	KEP	SMM	New SMM
Merger scheme	<ul style="list-style-type: none"> KOM to be sold to SMM KOM will exclude its legacy rigs & associated receivables and certain "Out-of-Scope" assets from the merger, eg Floatel and Dyna-Mac 	<ul style="list-style-type: none"> SMM to acquire KOM SMM will remain listed 	<ul style="list-style-type: none"> To issue 36.8 billion shares to KEP
Other scheme tied to the merger	<ul style="list-style-type: none"> KEP to sell legacy rigs and associated receivables to Asset Co Asset Co will be owned by Baluran Limited (74.9%), Kyanite (15.1%) and KEP (10%) Asset Co will enter into a master services agreement with CE for the completion of certain uncompleted rigs & the provision of other services 		
What each party gets	<ul style="list-style-type: none"> Receives 36.8b shares from SMM, implying a 54% stake SMM S\$0.5b in cash from KOM 10% stake in Asset Co S\$0.5m worth of shares in Asset Co S\$120m in 10% PIK Toggle perpetual securities S\$3.9b in 10-year 4% fixed-rate notes 	<ul style="list-style-type: none"> 46% stake post issuance of new shares to KEP 	<ul style="list-style-type: none"> S\$18b in net orderbook as at end-21 More than 30 projects in the orderbook
Other	<ul style="list-style-type: none"> To distribute in-specie 49% stake in SMM to its shareholders Retain 5% of SMM in segregated account for potential distribution to its shareholders at a later stage 		

Source: KEP, SMM

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