Sembcorp Industries

Charting a new course

SINGAPORE | ENERGY | INITIATION

- SCI shareholders could realise a total of $2.72 per share.
- IPO of Sembcorp Energy India Limited (SEIL) to crystalise value of SCI's India business unit, which we estimate to have a value of about about INR98bn or S$1.8bn.
- Potential positive re-rating of SCI following the demerger as profitability and return on equity improves in FY21e.
- Initiate with a BUY recommendation and a target price of $2.72.

Company Background

Sembcorp Industries (SCI) is a leading energy and urban development group, operating across multiple markets worldwide. As an integrated energy player, SCI is uniquely positioned to support the global energy transition. SCI's urban arm is a recognised Asian developer, and has saleable land of 2,600 hectares of saleable industrial, business, commercial and residential land.

Investment Merits

1. **SCI shareholders could receive a total of $2.72 per share**. Following the completion of the rights issue by SCM, we believe the market could assign a 0.7x FY21e P/BV for SCI (ex. SCM), a slight discount to their 10 year historical average of SCI (ex. SCM), which will give us $1.75/share. SCI shareholders will also receive 4.911 of SCM shares for every 1 share held. Based on SCM's last closing price of $0.199 on the 7 September, SCI shareholders could receive a total of $2.72/share ($1.75 + (4.911 x $0.199)).
2. **IPO of SEIL to crystalise value of SCI's India business unit**. While the timing of SEIL's listing remains uncertain, we believe this will happen sooner rather than later. SCI had intended to re-file their prospectus on SEIL in 2019, but postponed this to have full control in December last year. As sole owner now, we believe SCI will have full flexibility to evaluate a full range of growth opportunities in the renewables segment, while at the same time evaluate the right equity window to list their India business more expediently, which we estimate to have a value of about INR98bn or S$1.8bn.
3. **Potential positive re-rating of SCI following the demerger.** The deconsolidation of SCM will transform SCI into a Energy and Urban business. SCI will now be able to focus their resources on capturing growth opportunities in two of their key segments independently of SCM. Even though the conglomerate discount attached to SCI should narrow, we think this might take time as investor's confidence in the management could take time to rebuild. For FY21e and FY22e, we expect SCI to see ROE improve to 7.6% and 9.6% respectively from 2.7% in FY19, potentially leading to a positive re-rating of SCI.

Outlook

We are positive on the Group's outlook. We believe the deconsolidation of a SCM will unlock value for SCI shareholders through disciplined capital allocation and systematic capital recycling, and allow both companies to drive long-term value creation in their respective fields.

Initiating coverage with a BUY rating and target price of $2.72

We initiate coverage on SCI with a BUY recommendation and a target price of $2.72. We peg SCI to a P/BV of 0.7x FY21e, which is a slight discount to their 10 year historical average equity value (ex. SCM). SCI shareholders will also receive 4.911 of SCM shares for every 1 share held. Based on SCM's last closing price of $0.199 on the 7 September, SCI shareholders could realise a total of $2.72/share ($1.75 + (4.911 x $0.199). We expect SCI to see improved profitability and generate positive operating CF of $854mn and $1.2bn for FY21e and FY22e respectively, which will strengthen their balance sheet and puts them in a good stead to ride out the current crisis.

StocksBnB.com

9 September 2020

BUY (Initiation)

LAST CLOSE PRICE	SGD 1.920
FORECAST DIV	SGD 0.000
TARGET PRICE	SGD 2.720
TOTAL RETURN	41.7%

COMPANY DATA

BLOOMBERG CODE:	SCI SP
O/S SHARES (MN) :	1,786
MARKET CAP (USD mn / SGD mn) :	2521 / 3448
52 - WK HI/LO (SGD) :	2.36 / 1.36
3M Average Daily T/O (mn) :	8.21

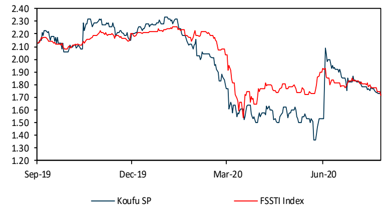
MAJOR SHAREHOLDERS (%)

TEMASEK HOLDINGS	49.5%

PRICE PERFORMANCE (%)

	1MTH	3MTH	1YR
COMPANY	1.1	25.5	(8.1)
STI RETURN	1.9	(7.9)	1.5

PRICE VS. STI



Source: Bloomberg, PSR

KEY FINANCIALS

Y/E Dec (S$, 'mn)	FY18	FY19	FY20e	FY21e
Revenue	11,689	9,618	7,142	5,785
Gross Profit	920	892	410	824
EBIT	667	565	126	623
NPAT	332.0	217.0	(146.7)	326.0
P/NAV (x)	0.4	0.4	0.8	0.8
P/E (x)	9.9	13.9	(23.3)	12.7
ROE (%)	4.1%	2.7%	-1.5%	7.6%

Source: Company, PSR

VALUATION METHOD

P/B Multiple @ 0.7x FY21e
+ 4.911 SCM shares (Distribution-in-specie)

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Background

Sembcorp Industries is a leading energy and urban development group, operating across multiple markets worldwide. They have three main business arms, energy, marine and urban.

On the 8 June 2020, SCI and Sembcorp Marine (SCM) (Not rated) announced the deconsolidation of their respective businesses. SCM provides innovative engineering solutions in the global offshore, marine and energy industries. Headquartered in Singapore, the SCM Group has close to 60 years of track record in the design and construction of rigs, floaters, offshore platforms and specialised vessels, as well as in the repair, upgrading and conversion of different ship types. Its solutions focus on the following areas: Gas value chain, renewable energy, process, advance drilling rigs, ocean living and maritime security.

As a diversified energy and urban player, SCI is uniquely positioned to provide integrated solutions to meet their stakeholders' needs. Leveraging technology and digital innovation, the draw on their deep understanding across their business and global track record to provide a suite of integrated energy and urban solutions that support the energy transition and sustainable development.

Key Business Segments

The Energy segment's activities are in the provision of power and water to industrial, commercial and municipal customers. Key activities in the power sector include power generation, process steam production, as well as natural gas importation. In the water sector, the business offers wastewater treatment as well as the production of reclaimed, desalinated and potable water for industrial use. In addition, the business also provides on-site logistics, solid waste management and specialised project management, engineering and procurement services

The Marine segment focuses on providing integrated solutions for the offshore and marine industry. Key capabilities include rigs & floaters, repairs & upgrades; offshore platforms and specialised shipbuilding. From the fourth quarter of FY20e, this will be deconsolidated from SCI.

The Urban segment owns, develops, markets and manages integrated urban developments comprising industrial parks as well as business, commercial and residential space in Asia.

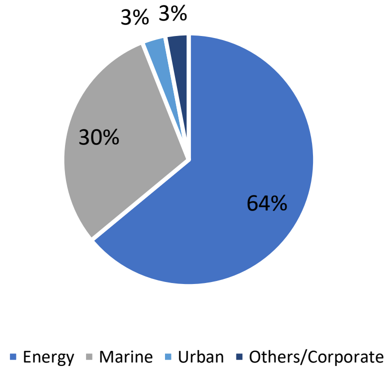
The Others/Corporate segment comprises businesses mainly relating to minting, design and construction activities, offshore engineering and others.

Figure 4: SCI will be focused on the Energy and Urban segment going forward

Our Businesses	Energy	Urban
Macro Themes	Global energy transition, low-carbon and cleaner energy	Urbanisation and sustainable development in Asia
Competitive Position	• Owner-operator of a balanced portfolio of high-efficiency thermal and renewable assets • Track record in renewable energy and environmental solutions including wind and solar power, battery storage and energy from waste • Proven deep integration expertise in the provision of solutions across the energy and utilities value chain	• Solid track record in transforming raw land into self-sufficient urban developments • Strong franchise in Asia • Delivers the economic engine to support industrialisation and urbanisation
Value Creation	• >12,600MW in power capacity, including 2,600MW of renewable power capacity • > 8.6 million m^3/day in water & wastewater treatment capacity	• 13 projects in Vietnam, China and Indonesia • US$34 billion in direct investments attracted to its projects • >1,000 tenants comprising multinationals and leading local enterprises
	Reposition as an integrated energy player	**Move up the value chain and leverage synergies with energy business**

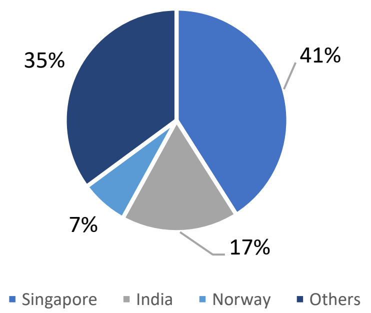
Source: Company

Figure 1: FY19 sales breakdown



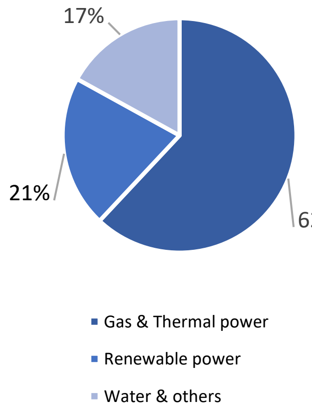
Source: Company, PSR

Figure 2: FY19 geographical sales



Source: Company, PSR

Figure 3: FY19 profit from operations by segment



Source: Company, PSR
(1) Excluding corporate and exceptional items

Investment Merits

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3. **Potential positive re-rating of SCI following the demerger.** The deconsolidation of SCM will transform SCI into a focused Energy and Urban business. SCI will now be able to focus their resources on capturing growth opportunities in two of their key segments independently of SCM. Even though the conglomerate discount attached to SCI should narrow, we think this might take time as investor's confidence in the management could take time to rebuild. For FY21e and FY22e, we expect SCI to see ROE improve to 7.6% and 9.6% respectively, potentially leading to a positive re-rating of SCI.

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The Transaction: Enhancing shareholder value and increased strategic focus

Recapitalised rights in SCM. SCM raised S$2.1bn in equity via a 5-for-1 renounceable rights issue of 10,463,723,020 new ordinary shares at S$0.20 per rights share. SCI undertook to subscribe for up to S$1.5b of SCM rights shares by setting off the outstanding principal of S$1.5bn under the subordinated loan facility extended to SCM, while Temasek Holdings has sub-underwritten the remaining S$0.6bn. With the proceeds, SCM has repaid SCI's S$1.5bn subordinated loan facility, improving their overall net gearing for proforma FY19 to 0.45x from 1.82x.

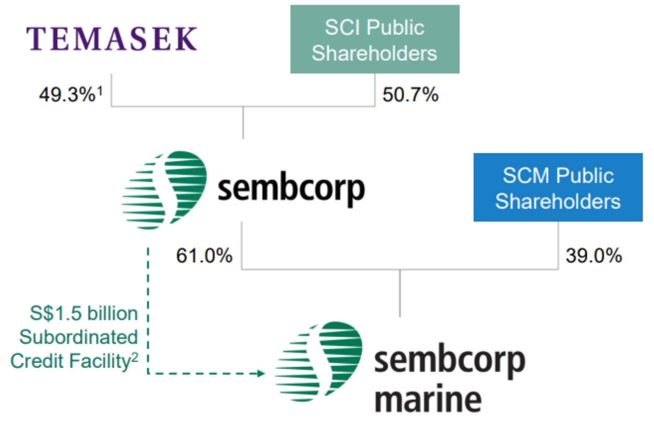
Figure 5: Recapitalised SCM will see improvements to cash flows, balance sheet and long-term viability

Selected key financials

	FY19	After rights issue
Pro Forma net gearing	1.82x	0.45x
Net tangible assets	S$1.9b	S$4.0b

Source: Company, PSR

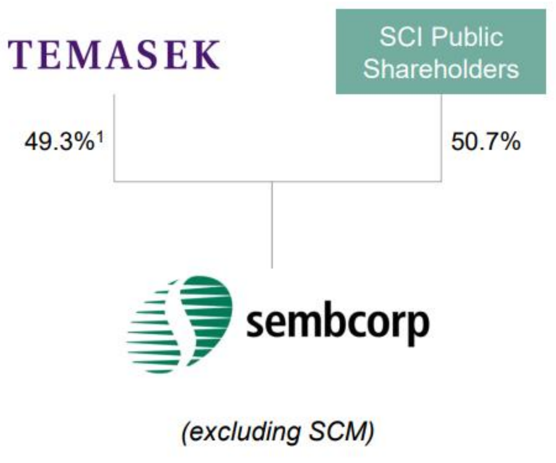
Figure 6: Pre-transaction



Source: Company, PSR
(1) Includes deemed interest held through Startree

Following the completion of SCM's rights issue, and SCI's subscription of 7,500,000,000 rights shares, representing approximately 72% of the 10,462,690,870 rights share available under the rights issue, **SCI will distribute 4.911 SCM shares per every 100 SCI shares held by shareholders on the last date of "cum-distribution" trading of SCI shares**. (see Figure 6 for pre-transaction and Figure 7 for post distribution). No payment is required from SCI shareholders to receive shares in SCM. SCI shareholders will have direct shareholdings in two focused companies, with Temasek alongside as a direct and significant shareholder. Importantly in our view, SCI shareholders now gain the flexibility to calibrate their holdings in the two companies based on their own investment objectives and strategy.

Figure 7: Post distribution



Source: Company, PSR

The Transaction: Enhancing shareholder value and increased strategic focus

The key terms of SCM's rights issue are summarised below.

Figure 8: Key Terms of SCM rights issue

SCM rights issue to entitled shareholders as at SCM record date

Gross Proceeds	Approximately S$2.1 billion
Allotment ratio	5 SCM rights shares for every 1 existing SCM share
Issue price	S$0.20 per SCM rights share
Pricing consideration	• Approximately 31.0% discount to TERP (1) of S$0.290 based on last 4-day VWAP • Approximately 35.1% discount to TERP of S$0.308 based on last close prior to announcement on the 3 June 2020 • Approximately 76.5% discount to last close on the 3 June 2020
Use of proceeds	• S$1.5 billion to repay the outstanding principal on the Subordinated Credit Facility • S$0.6 billion for SCM's working capital and general corporate purposes, including debt servicing.
Undertaking/ Underwriting and Sub-underwriting	• SCI undertakes to subscribe for its pro rata entitlements and apply for excess SCM rights shares, up to an aggregate of S$1.5 billion • DBS to underwrite and Temasek to sub-underwrite the balance of S$0.6 billion. No sub-underwriting fee.

Source: Company, PSR

(1) Theoretical ex-rights price

The key dates relating to The Transaction are detailed below.

Figure 9: Key dates relating to The Transaction

Date

8 September 2020	Last date of "cum-distribution" trading of the SCI shares
9 September 2020 at 9.00am	Expected commencement of "ex-distribution" trading of SCI shares
On or about 10 September 2020 at 5.30pm	Expected SCI record date for the proposed distribution
On or about 11 September 2020	Expected settlement date of the proposed SCM rights issue
On or about 11 September 2020	Expected date for crediting the SCM shares to SCI shareholders pursuant to the proposed distribution

Source: Company, PSR

On the 7 September, SCM announced the successful completion of the rights issue. The company announced that valid acceptances and excess applications were received for 9,434,192,612 rights shares, representing approximately 90.2% of the 10,462,690,870 rights shares available under the rights issue.

The Transaction: Enhancing shareholder value and increased strategic focus

Details of the valid acceptances and excess applications received for the rights shares are shown below (Figure 10):

Figure 10: Key dates relating to The Transaction

	Number of Rights Shares	As a percentage of the total number of Rights Shares available under the Rights Issue
Valid Acceptances	8,179,890,988	78.2%
Excess Applications	1,254,301,624	12.0%
Total	**9,434,192,612**	**90.2%**

Source: Company, PSR

Pursuant to the sub-underwriting agreement, Startree, a wholly-owned subsidiary of Temasek, has subscribed for the balance of 1,028,498,258 unsubscribed rights shares.

With the proceeds, SCM has repaid SCI's S$1.5bn subordinated loan facility, improving their overall net gearing for proforma FY19 to 0.45x from 1.82x and net tangible asset from S$1.9bn to S$4.0bn.

Figure 11: Post distribution

Source: Company, PSR

The Transaction: Enhancing shareholder value and increased strategic focus

Following SCI's subscription of 7,500,000,000 rights shares, representing approximately 72% of the 10,462,690,870 rights share available under the rights issue, SCI will distribute 4.91 SCM shares per every 100 SCI shares held by shareholders on the last date of "cum-distribution" trading of SCI shares. We have also detailed the financial metrics of SCI post-transaction in Figure 12 below.

Figure 12: SCI financial metrics pre- and post- transaction

	FY19 (reported)	Pro forma FY19	FY20e	FY21e
Return on equity	3.5%	7.9%	-1.5%	7.6%
Return on asset	3.5%	5.6%	-0.5%	2.1%
Debt levels	S$11.6bn	S$8.7bn	S$8.5bn	S$8.4bn
Profit attributable to owners of the Company	211	257	-147	326
Net tangible assets per share (S$)	3.49	2.05	2.30	2.49

Source: The Straits Times, Company, PSR

We see a number of positives in the move to separate SCI's core business from their marine interest in SCM. The primary benefit we believe is that the move will unlock value for SCI shareholders by creating two focused companies. New demand patterns emerging in the energy sector require SCI to be focused on competing effectively, and focused on their core businesses (Energy and Urban). However, SCI's future growth may be constrained by the SCI Group balance sheet which consolidates SCM's debt.

The settlement of SCM's subordinated loan with SCI and the proposed distribution delivered a clean demerger with an immediate deleveraging of SCM, which will benefit shareholders of SCM. SCI shareholders will receive SCM shares, with no cash outlay, in a recapitalised SCM with a significantly reduced net gearing from 1.82x to 0.45x due to the settlement of the subordinated loan with SCI and the improved cash position arising from the rights issue. SCI's profitability and returns profile will also improve going forward. We expect SCI to see an improvement in their profit from a loss of $147m in FY20e to $326m and $449m for FY21e and FY22e respectively.

Lastly, the demerger will create two focused companies, allowing SCI to focus on their core competency. The demerger also delivers a clear investment proposition and makes SCI more comparable to their peers, and also reduce the conglomerate discount attached to SCI. This is expected to lead to a potential positive re-rating of SCI.

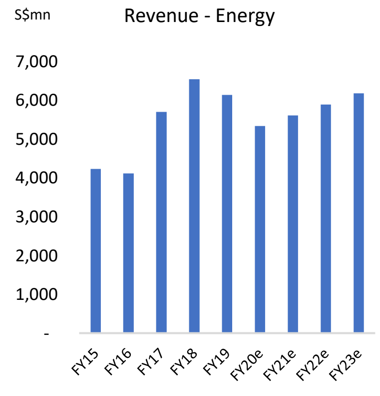
Revenue

Energy comprises 64% of FY19 revenue. SCI's energy business continues to undergo business transformation, as energy production continues to shift away from a reliance on fossil fuels to renewable energy. Over the years, SCI has been reshaping their energy portfolio mix into one that has a greater focus in renewable energy. Since 2016, net profit from their renewable business has increased nearly five-fold to S$80 million.

In their recent 1H20 results, turnover from this segment declined 19% compared to last year. The lower turnover was mainly due to the decrease in energy demand and prices from the reduction in economic activity and lockdowns arising from COVID-19. This adverse impact was mitigated by plants with long-term contracts where revenue is based on plant availability. For FY20e, we expect SCI to report S$5.3bn (-13% y-y) in revenue from this segment as the impact of COVID-19 and the reduction in economic activity as a result of lockdowns in multiple markets led to a decrease in energy demand and prices.

Going forward, Energy is expected to make up 97% of SCI's revenue from FY21e following the deconsolidation of SCM. We expect the recovery in this segment to be driven by a recovery in economic activity in Singapore, India and the UK as lockdowns in these markets ease resulting in a recovery in energy demand.

Figure 13: COVID-19 to negatively impact revenue for FY20e before recovering in FY21e



Source: Company, PSR

Marine comprises 30% of FY19 revenue. 2019 continued to be a challenging year for the Marine business with intense competition and continued low work volume adversely impacting overall performance. In their latest 1H20 results, turnover decreased 41% y-y while SCI's share of Marine net loss (before exceptional items) came in at S$117mn vs. the loss of S$6mn from the same period last year. Even though there has been no cancellation of any existing projects to date, there has also been no significant new orders this year. We expect SCM to continue reporting losses in FY20e and FY21e as intense competition and continued low work volume continue to weigh on their operations.

Following the deconsolidation of SCM, this segment will no longer contribute to the financial performance of SCI from FY21e.

Figure 14: Challenges persist in the Marine segment

Operational indicators

Marine (S$m)	FY18	FY19	1H20
Net orderbook (1)	3,088	2,436	1,900
New contracts secured	1,487	1,184	-

Source: Company, PSR

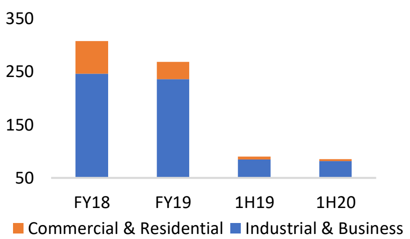
(1) Excluding Sete Brasil drillship contracts

Urban comprises 3% of FY19 revenue. SCI's urban businesses comprise mainly associates or joint ventures which are accounted for under the equity method, turnover of the business is therefore not material. In their latest 1H20 results, net profit of S$38mn was S$20 mn higher than the corresponding period last year. The improvement was largely due to the higher contribution from Nanjing's residential land sale and Kendal Industrial Park. Total land sales in 1H20 was 85 hectares, slightly lower than 1H19, and this is mainly due to lower land sales in Vietnam, offset by higher land sales in China and Indonesia.

For FY20e, we expect the profitability of the urban business to be lower vs. FY19 due to lower contribution from projects in China and Vietnam. COVID-19 has resulted in land property sales to be impacted, the uncertain economic outlook has led to lower take-up and demand, as well as delayed launches for some of the business' integrated developments and properties. We expect land and property sales to recover in FY21e as regulatory and other approvals resume following delays earlier in the year.

The Urban business still has a significant landbank of 2,600 hectares of saleable industrial, business, commercial and residential land. The integrated urban developments in Vietnam, China, and Indonesia, and that will underpin its future performance. The stabilisation of the economic outlook is expected to improve take-up for the business' integrated developments and properties.

Figure 15: Healthy land sales and net orderbook despite COVID-19

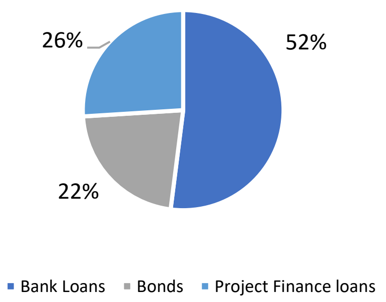


Source: Company, PSR

Balance Sheet

Based on their 1H20 results, SCI has a gross gearing and net gearing of 1.9x and 1.6x respectively. More than half (52%) of this is in bank loans, another 22% of this is in bonds while the remaining 26% is in project finance loans. SCI borrowings have a weighted average debt cost of 3.5%, of which 64% is fixed.

Figure 16: 1H20 Borrowing profile breakdown



Source: Company, PSR

Figure 17: SCI debt maturity profile as at Jun 30, 2020 (S$ million)

Date	Within 1 year	1 – 2 years	2 – 3 years	3 – 4 years	4 – 5 years	After 5 years	Total
Corporate	89	406	517	663	2,883	593	**5,151**
Project Finance	1,074	149	312	283	130	1,200	**3,148**
Sembcorp Marine	2,032	1,271	0	165	35	325	**3,828**
Total	3,195	1,826	829	1,111	3,048	2,118	**12,127**
%	26%	15%	7%	9%	26%	17%	**100%**

Source: Company, PSR

Following the rights issue by SCM, SCI's obligation to pay the SCM rights subscription amount has been offset against an equivalent amount of the principal amount outstanding and due and owing to SCI by SCM under the subordinated credit facility. We have detailed SCI's debt maturity profile after the transaction below.

Figure 18: SCI debt maturity profile after transaction (S$ million)

Date	Within 1 year	1 – 2 years	2 – 3 years	3 – 4 years	4 – 5 years	After 5 years	Total
Corporate	89	406	517	663	2,883	593	**5,151**
Project Finance	1,074	149	312	283	130	1,200	**3,148**
Sembcorp Marine	0	0	0	0	0	0	**0**
Total	1,163	555	829	946	3,013	1,793	**8,299**
%	14%	7%	10%	11%	36%	22%	**100%**

Source: Company, PSR

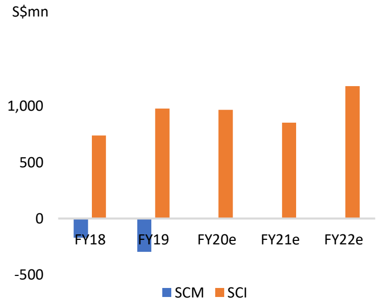
We estimate the proforma book value of SCI for FY20e to be S$4.1bn, or S$2.30 per share following the rights issue from SCM. We believe the market could ascribe a 0.7x P/Bv for SCI (ex.SCM) to account for its energy and urban development business. Even though our estimates suggest the forward ROE for FY21e and FY22e to be 7.6% and 9.6% respectively, we think confidence in the management's ability to execute will take time to realise, resulting in a discount in their overall net asset value.

While we acknowledge that the overall net gearing level will increase from 120.6% in FY19 to 187.1% for FY20e due to the lower equity base and the distribution-in-specie to SCI shareholders. We argue that the demerger will actually result in lower capital requirements gong forward as SCI will be able to focus on their core businesses without having capital tied up in SCM. Moreover, SCI's debt servicing ability will also improve post de-merger, and we expect that SCI will be able to reduce the debt load going forward. For FY21e and FY22e, we expect SCI's net gearing to be reduced to 176% and 155% respectively.

Cash Flow

Full year FY20e loss expected, but operating cash flow to remain positive. We expect SCI to report a loss of S$92mn for FY20e due to the expected continuing losses at SCM and the exceptional items amounting to S$191mn (Figure 20) recorded in 1H20. That said, we still expect SCI to report positive operating cash flow for FY20e.

Figure 19: SCM's negative OCF no longer a drag on SCI from FY21e



Source: Company, PSR
(1) SCM's OCF computed only for FY18 and FY19.

Figure 20: 1H20 exceptional items

Net profit impact

	S$ million
Singapore: Write-down of inventory of gasoil reserves to net realisable value	(38)
Singapore: Write-off of inventory due to uncertainty on recoverability of the gasoil inventory stored at Hin Leong Trading	(44)
Oman: Impairment of investment in Sembcorp Salalah Power and Water Company	(81)
Chile: Impairment due to change in net asset value of held-for-sale investment pending completion of divestment	(4)
Singapore: Preliminary negative goodwill recognised upon completion of acquisition of Veolia	6
Energy Exceptional items	(161)
China: Impairment on investment in Shenzhen Chiwan Sembawang Engineering Co.	(30)
Group Exceptional items total	(191)

Source: Company, PSR

Moving forward, we expect SCI to generate positive operating cash flow of S$853mn and S$1.2bn for FY21e – FY22e. Without the drag of SCM's negative cash flow, we expect a substantial improvement of SCI's operating cash flow from FY21e. The Energy and Urban businesses generate relatively stable long-term cash flow streams and the demerger with SCM will allow SCI to allocate capital solely to its core businesses.

While SCI has no fixed dividend policy in place, they have paid out dividends of between 4 and 5 Singapore cents for FY17- FY19, representing 24 – 42% dividend payout ratio. The Group's decision to suspend the interim dividend for 1H20 and to defer this to the full year reflects the challenging environment the Group is facing. With the demerger of SCM now completed and our expectation for the Group to report a positive operating cash flow for FY20e, we think the Group could pay out a dividend in for the full year FY20e. In our forecasts though, we have forecasted zero payout for FY20e to be prudent.

Notwithstanding the economic outlook beyond FY20e, we think the demerger of SCM will reduce the capital requirement of SCI as they focus capital on their respective businesses. For FY21e and FY22e, we expect SCI to report free cash flow of S$53mn and S$377mn respectively, which should support the resumption of their dividend payout.

Figure 21: Capital expenditure breakdown (S$ million)

Date	FY17	FY18	FY19	1H19	1H20
Energy	479	818	701	294	128
Marine	194	342	375	214	53
Urban / Other Business	16	7	9	1	6
Total	**689**	**1,167**	**1,085**	**509**	**187**

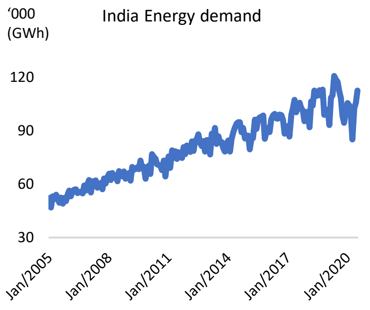
Source: Company, PSR

IPO of Sembcorp Energy India Ltd to crystalise value of India business

SCI could crystalise the value of their India business by listing their energy unit in India, Sembcorp Energy India Limited. SCI first filed its draft red herring prospectus lodged into the Securities Board of India in 2018, but subsequently withdrew this as it was injecting new equity into the business. SEIL further announced that it intends to refile a revised prospectus at "an appropriate time.., taking into consideration market conditions."

SCI first entered the India market in 2010, establishing itself as a reliable independent power producer in the country focused on growing a clean energy portfolio. With a presence across nine states, SEIL owns and operates 35 assets, adding up to a total power capacity of 4,370MW including 1,730MW of renewable energy. The outlook for the India market remains positive, energy consumption is expected to see an increase of over 100% from 2015 to 2035.

Figure 22: Energy demand in India has been on the rise



Source: CEIC, PSR

Figure 23: SCI's operating statistics of its first three wind auctions held by the Solar Energy Corporation of India (SECI)

SECI projects

Projects	SECI 1	SECI 2	SECI 3
Operational capacity (MW)	250	250	300
Power Purchase Agreements (years)	25	25	25
Wind Turbine Generator (WTG) model	2.1MW S111-120m WTGs		2.1MW G122 / T127m WTGs
# WTGs installed	119	120	143
Location	Tamil Nadu	Gujarat	
Impact	• Supplying power to seven states • Powering 600,000 homes with renewable energy • Avoided over 2 million tonnes of carbon dioxide equivalent emissions with renewable energy generated		
Total wind farm area	2,606 square kilometres (more than one and a half times the size of Delhi)		

Source: Company, PSR

SEIL owns and operates 2,640MW of thermal power projects consisting of Project 1 and Project 2. SEIL's bank facilities have a AA- rating, with a stable outlook awarded by India Ratings (a wholly-owned subsidiary of the Fitch Group).

Figure 24: Select financial summary of SEIL's Project 1 and Project 2 (S$ million)

(INR mn)	Project 1			Project 2		
	FY18	FY19	FY20	FY18	FY19	FY20
Total Income	41,787	38,211	43,810	33,178	38,558	30,852
EBITDA	13,323	14,087	15,755	5,512	8,039	7,310
Profit after tax	1,858	2,681	5,485	-8,187	-3,314	-4,298

Source: Company, India Ratings, PSR

Going forward, we believe SEIL will pursue longer-term power purchase agreements (PPAs) as these guarantee a stable tariff higher than the spot rate and also gives them access to domestic coal supply where prices are lower and more stable than imported ones. Unlike the short-term PPAs which suffer from thin or even negative spark spread, long-term PPAs provide more profit visibility for plants. For FY19, India posted a net profit of S$100mn (accounting for 48% of their FY19 profit) vs. S$47mn in 2018 mainly due to the higher contribution from its thermal power plants as well as improved operating performance by its renewable energy assets on better wind resources and new capacity addition.

IPO of Sembcorp Energy India Ltd to crystalise value of India business

Renewable energy companies in India trade at about 1.7x of their book value, based on SEIL's FY19 book value of INR65.4bn, this implies a market capitalisation of about INR111.2bn (or about S$2.1bn). We impute a slight discount to the sector average P/BV to account for SEIL's lack of a listing track record to arrive at a valuation of INR98.1bn or S$1.8bn (~1.5x FY19 P/BV).

Figure 25: Renewable Energy comparables in India

Comparables

Company	Mkt cap (INR mn)	PE Yr 0	FY19 EPS growth (%)	FY20e EPS growth (%)	FY19 net profit margin	P/BV Yr 0	FY19 ROE (%)	ROE Yr 1 (%)	FY19 EV/EBITDA (x)	FY19 Dividen yield (%
Adani Green Energy Ltd	865,056	N/A	95.1	N/A	-0.9%	10.2	-1.1%	N/A	25.6	N/A
NHPC Ltd	214,461	7.5	12.6	0.24	38.2%	0.6	9.2%	8.9%	7.8	7.0
SJVN Ltd	92,547	6.2	9.8	N/A	61.4%	0.7	14.4%	N/A	4.0	9.3
Jaiprakash Power Venture	18,811	N/A	-464.3	N/A	-62.4%	0.0	-24.7%	N/A	5.7	N/A
Rattanindia Power Ltd	15,807	6.5	-99.5	N/A	9.3%	1.6	N/A	N/A	22.3	N/A
Orient Green Power Ltd	1,501	4.1	32.3	N/A	6.2%	0.2	3.9%	N/A	6.3	N/A
Urja Global Ltd	1,420	127.3	N/A	N/A	0.7%	0.3	0.7%	N/A	57.2	N/A
Indowind Energy Ltd	283	315.0	41.6	N/A	0.2%	0.1	0.0%	N/A	12.1	N/A
Average	151,236	77.8	-53.2	0.2	6.6%	1.7	0.4%	8.9%	17.6	8.2
Sembcorp Energy India Ltd	N/A	N/A	n.m	N/A	1.4%	N/A	2.0%	N/A	N/A	N/A
Average	151,236	77.8	-53.2	0.2	6.0%	1.7	0.6%	8.9%	17.6	8.2

Source: Company, PSR

While the timing of SCI's India Energy IPO remains uncertain, we believe SCI's acquisition of the remaining 5.95% stake in SEIL for INR4.6bn (approximately ~S$77mn) in December last year (implying a 1.2x FY19 P/BV or a market capitalisation of INR77.3bn or S$1.5mn) will allow SCI to have the flexibility as sole owner to evaluate and pursue a full range of growth opportunities in the renewables segment, while at the same time seeking the right equity window to list its India business or to pursue other capital-recycling options.

Future plans

Going forward, we think SCI's future focus will centre around the following themes set out below:

1) Drive long-term value creation and performance through disciplined capital allocation and systematic capital recycling;
2) Unlock value with targeted utilities divestments of up to S$0.5 billion and proposed IPO of India energy business; and
3) Strengthen commitment to sustainability with targets for doubling of renewables portfolio to approximately 4,000 megawatts by 2022 and a 25% reduction in carbon emission intensity.

SCI transformed into a focused Energy and Urban business. SCI's move to deconsolidate SCM will allow SCI to focus their resources and efforts on repositioning its Energy and Urban business, and capturing growth opportunities to provide solutions that support the energy transition and sustainable development. To that end, we believe SCI will focus on growing their renewables capacity, and reach approximately 4,000 megawatts by 2022.

Net profit from SCI's renewable energy portfolio has increased by a CAGR of 67.6% per year from FY16 – FY19. As a proportion of total net profit from Energy, this has increased from just over 2% to 8.4% in FY19. Going forward, we expect SCI to grow their renewables energy footprint in key markets in Singapore, China, India and the UK. In Singapore, construction of the 60 MWp floating solar photovoltaic system on Tengeh Reservoir (see Figure 27) commenced last month. The project is expected to begin full commercial operations next year with a 25-year power purchase agreement signed with PUB, Singapore's National Water Agency.

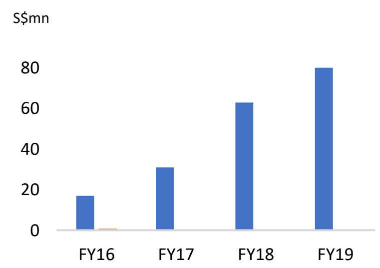
The Energy and Urban business has historically generated relatively stable long-term cash flow streams, even with the Energy market exposed to the merchant market. We think the demerger will allow SCI to allocate capital solely to its core businesses. We expect their balance sheet and cash flows to improve post deconsolidation from SCM as the capital requirement falls. We expect net gearing to be reduced from 187% in FY20e to 177% and 155% for FY21e and FY22e respectively.

For their Urban business, SCI still has remaining saleable land of 2,600 hectares of saleable industrial, business, commercial and residential land (see Figure 28). In our view, SCI is positioned in key growth areas in Vietnam, China and Indonesia. In Vietnam, they have nine projects strategically located in the southern, central and northern economic zones. In China, they are situated in key growth regions, and are well placed to benefit from the shift towards central-western China development. In Indonesia, central Java is expected to benefit from spillover investments from Jakarta.

We see a number of synergies in SCI's Energy and Urban business, and we believe SCI will focus on capturing trends like urbanisation, electrification and decarbonisation.

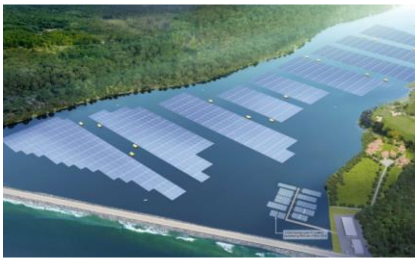
The listing of SEIL will recycle capital and crystalise value on SCI's India Energy portfolio. While the timing of SEIL's listing remains uncertain, we think this will happen sooner rather than later. SCI's move to acquire the remaining 5.95% stake in SEIL last December (implying a 1.2x FY19 P/BV or a market capitalisation of INR77.3bn or S$1.5mn) will give the company more flexibility as sole owner to evaluate and pursue a full range of growth opportunities in the renewables segment, while at the same time seeking the right equity window to list its India business or to pursue other capital-recycling options.

Figure 26: Renewable Energy net profit increased 67.6% CAGR from FY16 to FY19



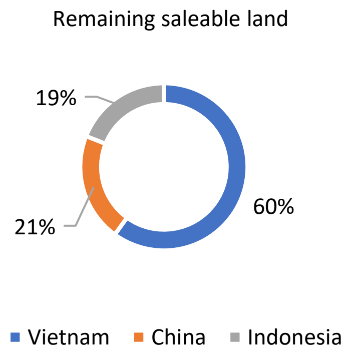
Source: Company, PSR

Figure 27: Artist impression of the upcoming 60MWp floating solar system on Tengeh Reservoir occupying an area of about 45 football fields



Source: Company

Figure 28: Remaining saleable land of 2,600 hectares in Vietnam, China and Indonesia



Source: Company, PSR

Valuation

We initiate coverage on Sembcorp Industries with a BUY recommendation and a target price of $2.72. We peg SCI (ex. SCM) to a P/Bv of 0.7x FY21e, and 4.911 distributed shares in SCM to calculate the SCM shares to be distributed to SCI shareholders. In total, we expect that SCI shareholder could get $2.72 based on our assumptions below.

We believe the market could assign a 0.7x P/BV for SCI (ex. SCM), a slight discount to the 10 year historical average of the implied SCI (ex. SCM) P/BV to account for their Energy and Urban business to S$1.75 a share. Based on the 7,500,000,000 rights shares which SCI had subscribed for in accordance with the SCI undertaking agreement, this means that 4.911 of SCM shares will be distributed to SCI shareholders. Based on SCM's last closing price of S$0.199 on the 7 September, SCI shareholders could receive a total of S$2.72 (Figure 29). Our forecast of SCI does not include a valuation on SCM.

Figure 29: Valuation of SCI based on The Transaction

		(S$ mn)	S$ / share
SCI FY21e Equity value assuming SCI subscribe for the undertaking of SCM rights (ex. SCM)		4,459	
Ascribed 0.7x P/Bv of FY21e P/Bv (1)		**3,121**	**1.75**
Number of SCM shares:			
- based on maximum distribution ratio (2)	**4.911**		
SCM last traded price (as at 7 Sept 2020)			0.199
Total value of SCM distributed shares (1) x (2) = (3)			**0.98**
Total SCI shareholders will receive (1) + (3)			2.72

Source: Bloomberg, PSR

The recapitalisation of SCM, followed by a demerger to create two focused companies will allow SCI to focus on their core competency. The demerger also delivers a clear investment proposition and makes SCI more comparable to their peers. The deconsolidation of SCM will transform SCI into a focused Energy and Urban business. SCI will now be able to focus their resources on capturing growth opportunities in two of their key segments independently of SCM. Even though the conglomerate discount attached to SCI should narrow or disappear, we think this might take time as investor's confidence in the management could take time to rebuild. For FY21e and FY22e, we expect SCI to see ROE improve to 7.6% and 9.6% respectively, potentially leading to a positive re-rating of SCI.

Risks

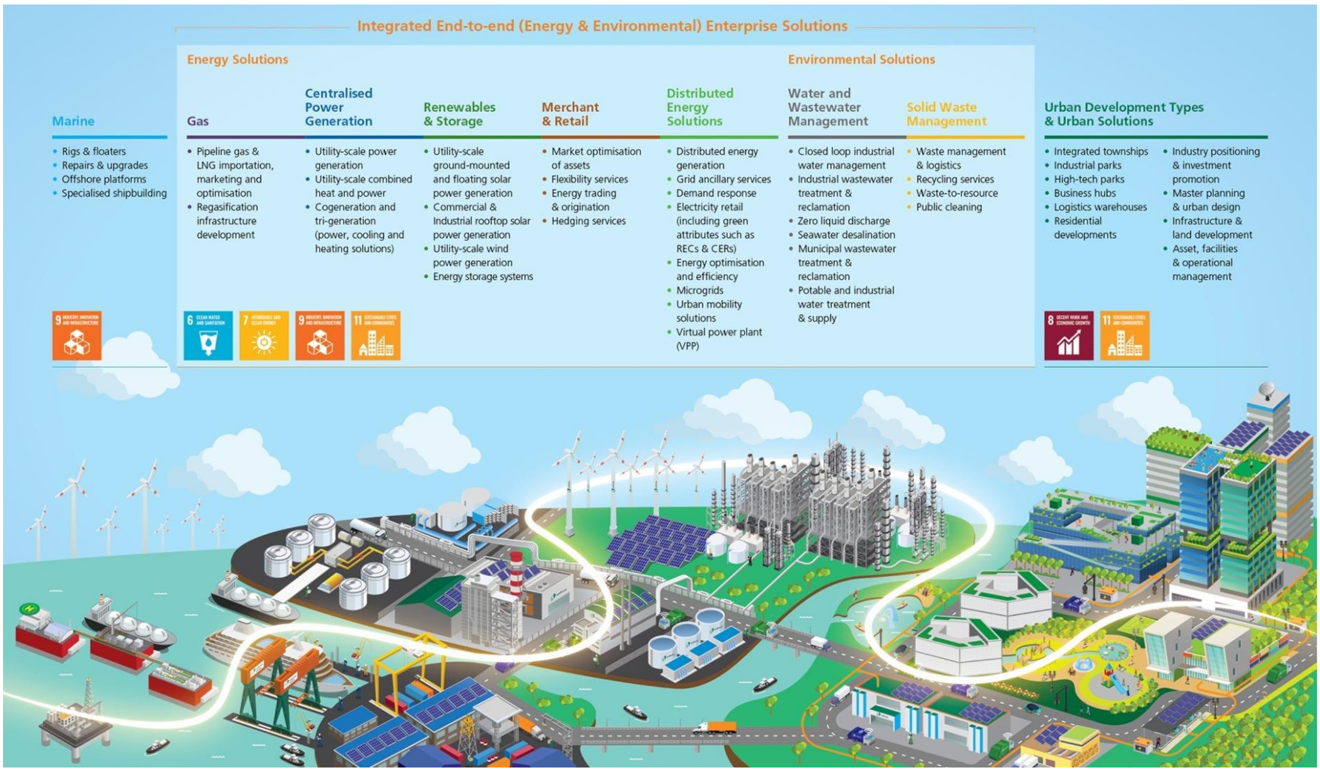
Continued lockdowns in SCI's key markets like Singapore, China, India and UK due to COVID-19 resulting in decrease in energy, demand and prices. With little signs of COVID-19 cases worldwide abating, any lockdowns or extensions in lockdowns in SCI's key markets like Singapore, China, India and UK will result in a reduction in economic activity, resulting in a decrease in energy, demand and prices. In 2Q20, energy demand in Singapore, India and the UK have all declined by approximately 5% to 20%, compared to the same period last year.

Uncertain economic outlook could affect take-up and demand for SCI's integrated developments and properties. Measures undertaken by various governments to contain the COVID-19 pandemic can result in delays in regulatory and other approvals required for the Urban business' projects. These delays in approvals accompanied with the uncertain economic outlook will have a negative impact on the overall take-up and demand for the Group's integrated developments and properties.

APPENDIX 1 – Background

A merger of Sembawang Corp and Singapore Technologies Industrial Corp in 1998 resulted in the formation of SCI, with businesses spanning a wide range of industries such as Infrastructure, Marine Engineering and Information technology. SCI is now a more focused company.

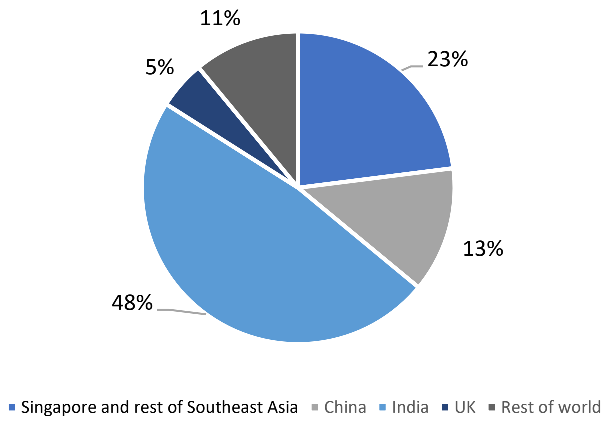
Figure 30: Multi-brand strategy widens their customer base



Sembcorp Energy UK, a wholly-owned subsidiary of SCI, is an integrated energy business and leading provider of flexibility offering a range of solutions to the UK energy system supplying rapid-response power direct to the grid when it's needed most. Sembcorp Energy UK has a total operational portfolio of 973MW that includes significant battery storage. Sembcorp Energy UK's major industrial power plants on Teeside along with its delivery of high-quality, centralised utilities and services to its energy-intensive manufacturers are complemented by the fleet of fast-acting, decentralised power stations situated throughout England and Wales.

Sembcorp has been investing in the China market for around two decades. From renewable energy and high-efficiency power generation facilities, to innovative industrial water and wastewater treatment solutions, and sustainable urban developments, Sembcorp's presence spans 15 provincial regions across the country. Sembcorp China has a growing renewable energy contribution and currently has 725MW of onshore wind power projects.

Figure 31: Profit from operations by Geography



Source: Company, PSR

Sembcorp Energy India Limited is a leading independent power company in India, with a successful track record of identifying, developing and operating power generation assets across the thermal and renewable power sectors in India. Sembcorp Energy India Limited has over 1,700MW of wind and solar power projects across seven states. They have the highest renewables capacity under self-operations.

Figure 32: Business description of Indian renewable energy companies

Company	Business description
Adani Green Energy Ltd	Adani Green Energy Limited operates as a producer of renewable energy. The Company builds, owns, and operates power plants for solar and wind energy. Adani Green Energy serves customers worldwide.
NHPC Ltd	NHPC Limited is a hydro-power development company. The Company constructs and develops hydro-power projects with a total installed capacity. NHPC operates in India and abroad.
SJVN Ltd	SJVN Limited is a power company. The Company develops, owns, and operates Hydro-electric power projects in India.
Jaiprakash Power Venture	Jaiprakash Power Ventures Ltd. generates electricity. The Company operates a private sector hydroelectric power plant.
Rattanindia Power Ltd	RattanIndia Power Limited develops, constructs and operates power projects domestically and internationally. The Company is participating in various Coal based Thermal,Hydro and Renewable Energy projects as well as is actively pursuing various coal mining opportunities.
Orient Green Power Ltd	Orient Green Power Co Ltd. produces electricity using renewable fuels. The Company develops, owns and operates wind, biomass and small hydroelectric power plants in India.
Urja Global Ltd	Urja Global Ltd. develops electricity generating projects and manufactures generating equipment. The Company develops and manages hydroelectric and thermal power plants; and manufactures photovoltaic modules.
Indowind Energy Ltd	Indowind Energy Limited is an alternative energy company that develops wind farms for commercial exploitation.

Source: Company, PSR

Financials

Income Statement

Y/E Dec, ($'mn)	FY17	FY18	FY19	FY20e	FY21e
Revenue	**9,026**	**11,689**	**9,618**	**7,142**	**5,785**
Cost of sales	(7,791)	(10,769)	(8,726)	(6,732)	(4,961)
Gross Profit	**1,235**	**920**	**892**	**410**	**824**
General and Administrative expe	(420)	(408)	(447)	(321)	(231)
Other operating income	75	107	222	144	30
Other items	30	48	(102)	(107)	-
EBIT	**920**	**667**	**565**	**126**	**623**
Net finance expenses	(473)	(421)	(454)	(440)	(419)
Share of results of associates an	164	174	184	189	189
Profit before tax	**611**	**420**	**295**	**(125)**	**393**
Taxation	(118)	(88)	(78)	(21)	(67)
Net Profit	**493**	**332**	**217**	**(147)**	**326**
Net Profit (excl. SCM from FY20e)	**493**	**332**	**217**	**(92)**	**326**
Profit attributable to owners	**383**	**347**	**247**	**(147)**	**271**

Per share data (S$ cents)

Y/E Dec	FY17	FY18	FY19	FY20e	FY21e
BVPS	4.6	4.4	4.4	2.3	2.5
DPS	5.0	4.0	5.0	-	5.3
EPS	21.4	19.4	13.8	(8.2)	15.1

Cash Flow

Y/E Dec, ($'mn)	FY17	FY18	FY19	FY20e	FY21e
CFO					
Net income	**493**	**332**	**217**	**(147)**	**326**
Adjustments	1,019	918	1,238	1,113	861
WC changes	(791)	(389)	(379)	1,910	(266)
Cash generated from ops	**721**	**861**	**1,076**	**2,877**	**920**
Others	(70)	(122)	(99)	(56)	(67)
Cashflow from ops	**651**	**739**	**977**	**2,821**	**854**
CFI					
CAPEX, net	(736)	(1,107)	(925)	(967)	(800)
Others	644	(110)	474	166	204
Cashflow from investments	**(92)**	**(1,217)**	**(451)**	**(801)**	**(596)**
CFF					
Dividends paid to owners	(125)	(71)	(71)	(54)	(36)
Proceeds from borrowings, net	778	855	86	(1,513)	(100)
Interest paid	(484)	(486)	(544)	(538)	(428)
Others	107	(554)	(163)	(808)	-
Cashflow from financing	276	(256)	(692)	(2,912)	(564)
Net change in cash	835	(734)	(166)	(892)	(306)
Cash at the start of the period	1,854	2,681	1,922	1,739	847
Currency translation	(8)	(1,825)	(27)	(27)	(27)
Others	-	-	-	-	-
Ending cash	**2,681**	**1,922**	**1,739**	**847**	**541**

*nm - not meaningful

Balance Sheet

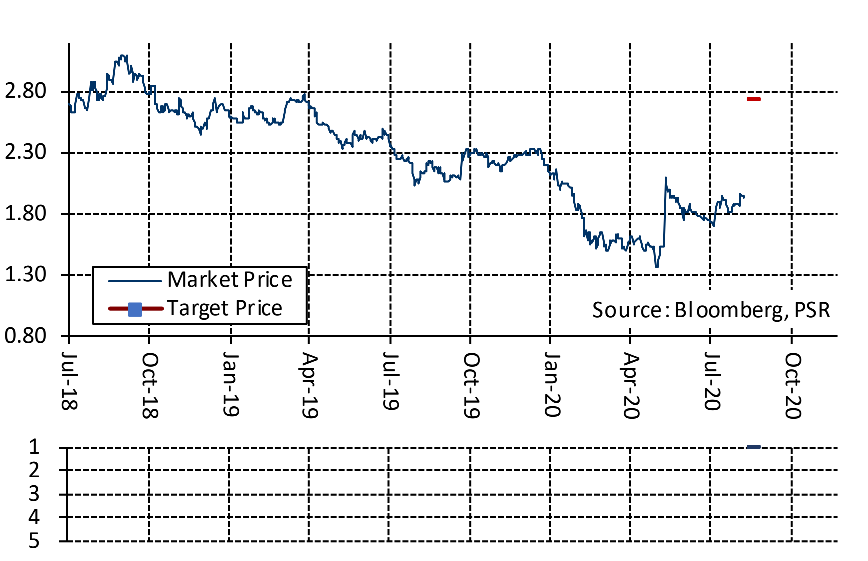
Y/E Dec, ($'mn)	FY17	FY18	FY19	FY20e	FY21e
ASSETS					
PPE & Investment Properties	11,249	11,782	11,867	8,136	8,436
Others	4,004	5,215	5,290	3,871	3,619
Total non-current assets	**15,253**	**16,997**	**17,157**	**12,007**	**12,054**
Cash and cash equivalents	2,687	1,925	1,767	847	540
Inventories	524	513	386	269	198
Trade and other receivables	2,094	2,311	2,048	1,530	1,239
Others	3,187	1,575	1,894	1,446	1,722
Total current assets	**8,492**	**6,324**	**6,095**	**4,091**	**3,700**
Total Assets	**23,745**	**23,321**	**23,252**	**16,099**	**15,755**
LIABILITIES					
Trade and other payables	3,340	2,968	2,844	2,242	1,652
ST borrowings	1,572	1,862	2,643	1,197	1,072
Others	1,421	746	525	462	487
Total current liabilities	**6,333**	**5,576**	**6,012**	**3,901**	**3,211**
LT borrowings	8,275	8,870	8,627	7,344	7,344
Others	963	937	734	741	741
Total non-current liabilities	**9,238**	**9,807**	**9,361**	**8,084**	**8,084**
Total liabilities	**15,571**	**15,383**	**15,373**	**11,986**	**11,296**
EQUITY					
Share Capital	566	566	566	77	77
Retained profits	5,460	5,669	5,827	4,195	4,485
Others	2,148	1,703	1,486	(159)	(104)
Total equity	**8,174**	**7,938**	**7,879**	**4,113**	**4,459**
Total equity and liabilities	**23,745**	**23,321**	**23,252**	**16,099**	**15,755**

Valuation Ratios

Y/E Dec	FY17	FY18	FY19	FY20e	FY21e
P/E (x)	9.0	9.9	13.9	-23.3	12.7
P/B (x)	0.4	0.4	0.4	0.8	0.8
EV/EBITDA (x)	-	18.3	22.9	88.6	18.2
Dividend yield (%)	2.6%	2.1%	2.6%	0.0%	2.8%
Growth & Margins (%)					
Growth					
Revenue	14.2%	29.5%	-17.7%	-25.7%	-19.0%
Gross profit	11.8%	-25.5%	-3.0%	-54.0%	101.1%
EBIT		-27.5%	-15.3%	-77.8%	396.0%
PBT	39.8%	-31.3%	-29.8%	-142.5%	-413.2%
Margins					
Gross profit margin	13.7%	7.9%	9.3%	5.7%	14.3%
EBIT margin	10.2%	5.7%	5.9%	1.8%	10.8%
Net profit margin	5.5%	2.8%	2.3%	-1.3%	5.6%
Key Ratios					
ROE	6.0%	4.1%	2.7%	-1.5%	7.6%
ROA	2.1%	1.4%	0.9%	-0.5%	2.0%
Net Gearing (%)		110.9%	120.6%	187.1%	176.6%

Source: Company, Phillip Securities Research (Singapore) Estimates

Ratings History



PSR Rating System

Total Returns	Recommendation	Rating
> +20%	Buy	1
+5% to +20%	Accumulate	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce	4
< -20%	Sell	5

Remarks

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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