KIT | KEPPEL INFRASTRUCTURE TRUST

(Business Trust Registration Number 2007001)
(Constituted in the Republic of Singapore as a business trust pursuant to a trust deed dated 5 January 2007 (as amended))

SIAS-Keppel Infrastructure Trust Virtual Information Session for the Proposed Base Fee and Performance Fee Supplement held on 6 April 2022, 7.00pm

Transcript of the Question & Answer Session

JC: Jopy Chiang, Chief Executive Officer, Keppel Infrastructure Fund Management Pte Ltd (KIFM)
EN: Eric Ng, Chief Financial Officer, Keppel Infrastructure Fund Management Pte Ltd (KIFM)
DG: David Gerald, Founder, President & CEO, Securities Investors Association (Singapore) (SIAS)

DG: Since the announcement, we have been receiving questions from Unitholders on the proposed fee amendments, so we will start from questions from SIAS. How would the proposed fees amendments affect DPU?

JC: We delivered KIT's first-time DPU increase of 1.6% to 3.78 cents for FY 2021, breaking away from the fixed distribution per unit (DPU) payment of 3.72 cents that KIT has paid out since 2016. This was a deliberate and considered move that management took in consultation with the Board, following feedback on the stagnant DPU garnered from various conversations with investors. This first-time increase in DPU is symbolic and is supported by the strong performance and cashflow contribution from the KIT portfolio in the past two years. KIT's assets, majority of which are classified as essential and critical infrastructure, have weathered through the pandemic well, which is a testament to the strength of KIT's portfolio. The strategic acquisitions of Ixom in 2019 and Philippine Coastal Storage & Pipeline Corporation (Philippine Coastal) in 2021, as well as the recent investment in the Aramco Gas Pipelines Company in the Kingdom of Saudi Aramco in February this year, have improved the diversification and resiliency of KIT's cashflow profile. This underpins the confidence that we have in sharing and sustaining this growth with Unitholders going forward, in a prudent and sustainable manner.

The Trustee-Manager took reference from the average headline inflation rate of 1.52% in Singapore over the last 30 years as a benchmark, to arrive at the 1.6% increase in DPU for FY 2021. Weighing the strength and resiliency of the portfolio, Management is confident of delivering sustainable and growing distributions to Unitholders.

Lastly, the proposed fee amendments would better align the Trustee-Manager's interests with that of Unitholders. It is key to note that the Proposed Performance Fees are only payable with DPU growth.

DG: The Proposed Performance Fees being only payable with DPU growth is music to Unitholders' ears. The structure is also adopted by newly listed Singapore Real Estate Investment Trusts (SREITs) and is not new. The Independent Financial Adviser (IFA) have also supported the view and the Institutional Shareholder Services (ISS) has also recommended that Unitholders vote in favour of the proposed fee structure. If we look at KIT's growth since the formation of the enlarged CitySpring Infrastructure Trust which was renamed KIT in 2015, what is the growth in terms of Distributable Income and assets under management (AUM)?

JC: Since the merger in 2015, KIT's Distributable Income has grown at a CAGR of 8% from end-2015 to end-2021. AUM has grown at a CAGR of 1.5% from $4.1 billion as at end-2015 to $4.6 billion today.

DG: What are your plans to maintain the DPU trajectory going forward?

JC: We have done some housekeeping last year and made our first investment into the Middle East back in February 2022. Basslink, which has been a perennial matter for KIT, was resolved in November 2021, and we do not expect any liabilities from the asset going forward. We have also made our first investment in the Middle East in February 2022, and we are looking to enter new markets, such as Europe, where we see many opportunities with attractive risk-adjusted return profiles. A larger and diversified portfolio across geographies and sectors will allow us to improve the cashflow resiliency of the Trust.

DG: How does the proposed fee structure align with Unitholders' interest?

JC: The world is fast-changing, and it is imperative that we continue to adapt and evolve accordingly. The existing fee structure was inherited from K-Green Trust's listing in 2010, and it is not well-aligned with Unitholders' interests, as the Base Fee is a fixed dollar value with no nexus to the size of the portfolio.

You rightly pointed out that this is not a new fee structure. We conducted an extensive benchmarking exercise, and our findings show that 11 other REITs in Singapore have the same fee structure. The existing Performance Fee is not a true performance fee as it is 4.5% of the Operating Cash Flows of the Trust and the existing Base Fee of $2m adjusted for Singapore CPI is not correlated to the size of the trust. Unitholders want more DPU and we will strive to do better every year. With the proposed Base Fee, the Trustee-Manager does not receive an additional dollar in fees, unless we are able to grow Distributable Income. Therefore, we feel that the proposed fee structure is well-aligned to Unitholders' interest. When we benchmark against global infrastructure funds, as well as Business Trusts and REITs in Singapore, it is evident from the findings that the proposed fee structure is within the market range based on a percentage of Revenue, Market Capitalization and AUM.

DG: Why was KIT's DPU flat for 6 years, even when KIT's AUM has increased?

JC: This was one of the key items that we wanted to address, and I am pleased to say that we declared a 1.6% DPU increase earlier this year, which is the first in KIT's history. It is our intention to continue to maintain growth in a sustainable manner, to preserve the income for our Unitholders in real terms, taking into consideration long-term historical inflation in Singapore.

DG: Are you asking for a fee increase because you need additional resources to grow? Is the current 4.5% fee out of the Trust Income insufficient to support KIT's growth?

JC: The current fee structure has no correlation to the size of the portfolio, and at a certain point, it may potentially act as an impediment to KIT's continued growth, which would be an undesirable outcome for Unitholders. The results of the benchmarking exercise conducted for the proposed fee structure against peers show that it is in line with the market. The IFA, Ernst & Young, has also opined that the proposed fee amendment is on normal commercial terms. More importantly, we want to emphasise that the proposed fee structure supports future growth, all for the benefit of Unitholders.

We see compelling investment opportunities in Europe, and we are looking to move into new sectors and new markets, tapping on strong megatrends such as decarbonisation and digitalisation. We see attractive opportunities to grow, rejuvenate, and replenish the existing portfolio to reposition the Trust and improve portfolio resiliency for the long term, and to do this, we need resources. This will help us accelerate our growth for the benefit of Unitholders. We are cognisant of the yield that we deliver to Unitholders, and we will strive to continue to do better each year.

DG: Has KIT turned down or rejected any potential acquisition due of the fee structure?

JC: Acquisitions are evaluated holistically across different factors and considerations, including yield, returns, capital structure and portfolio accretion. It will not rest solely on a single factor such as the fee structure. Having said that, we do take into consideration the existing and proposed fee structure when we are assessing investment opportunities. For any potential acquisition, we maintain a high degree of discipline to ensure that threshold levels of target accretion are met before deciding to move forward.

DG: Can the Trustee-Manager assure Unitholders that it has discharged its duties and had always done its best for the benefit of Unitholders?

JC: KIT plays a critical role in supporting Singapore's circular economy and driving economic growth, in Singapore and overseas, through our businesses and assets. For example, in Singapore, KIT incinerates roughly 40% of the nation's waste, produces roughly 20% of water, owns 100% of the town gas production and distribution facility via City Energy and has a 51% stake in a 1,300 MW combined cycle gas turbine generation facility which sells electricity to Keppel Electric. Environmental, Social and Governance (ESG) is at the core of our strategy, and we look to support economies with their energy transition plans. An example of this is our recent investment in the gas pipeline network of the Kingdom of Saudi Arabia, which is a core infrastructure asset contributing to the decarbonization efforts of the country.

We are tremendously proud of the strong and stellar operational track record that we have maintained to date. KIT's portfolio of assets run 24/7 365 days a year, with the support of our Asset Management team. We are fully cognizant of our fiduciary duties and stewardship towards our Unitholders, and we will always act in the best interests of Unitholders, as we always have and will relentlessly continue to do so. And it is therefore in this spirit, that Management strongly believes that the proposed fee structure is key and critical to support the continued growth and repositioning of KIT's portfolio, to enable and ensure the trajectory of DPU growth that we have introduced. A larger, enhanced and diversified portfolio across geographies, sectors and counterparties, will require more resources, and will ensure that KIT is best positioned for the long-term.

DG: To help unitholders understand the impact of the proposed fees, can you share the fees that would have been paid to the Trustee-Manager (without any progressive implementation), assuming the proposed fees have been in place for the last 5 years?

EN: We provided a pro forma analysis of the effect of the proposed fee structure for the past two years in the circular. The fee increase is forward looking and is expected to cover the expected higher cost base required to support the growth strategy. It would not be meaningful to look back and compare against the fee five years ago as we were operating at a lower cost base with a different strategic direction.

DG: From FY 2016 to FY 2021, the Trustee-Manager reported profits of $30.6 million. All these out of a share capital of $1.0 million. Looking at the cash flow over the same period, the Trustee-Manager declared and paid out dividends of $29.2 million to Keppel Capital. Can you share if KIT has proposed that Keppel Capital reinvest some of these dividends into the Trustee-Manager to build up the capabilities that you need?

JC: Firstly, the net margin of the Trustee-Manager is at a reasonable amount, ranging from 20-28% historically, which is also well in line with our peers. We have plans to double our bench strength from roughly 20 currently, in line with AUM growth. We are at approximately $4.6 billion today, and we have plans to increase our AUM to $18 billion within the decade. There is a strong acquisition pipeline ahead of us across stable, developed economies with strong legal and regulatory frameworks, and we are working hard to deliver and share this growth with Unitholders.

We lean heavily on the strength of the Keppel ecosystem, and we benefit greatly from the vast network across the various business verticals. E.g. Keppel Telecommunications & Transportation (KTT) is constructing a subsea fiber cable system from Singapore to the West Coast of North America, which was a project developed by KTT in partnership with Facebook and Telin. This is an example of an attractive digital infrastructure asset with a long-term revenue contract denominated in US dollars, and could potentially be a suitable asset for KIT once fully operational. At Keppel Offshore and Marine, Keppel Shipyard delivered Hilli, the world's first successfully converted floating LNG vessel with its partner Golar LNG. Its successor project, Gimi, is a US$1.5 billion FLNG which is currently under construction at the Keppel Shipyard. Gimi has a 20-year USD-denominated lease agreement with British Petroleum, providing strong visibility on cash flows. These are some examples of the proprietary deals that we can originate from the Keppel ecosystem, and when fully operational and adequately de-risked, are strong potential candidates for the acquisition pipeline.

DG: You have grown from $760 million in 2010 to approximately $4.6 billion now. How would your AUM look like in five years' time?

JC: Through the pandemic, KIT has continued to deliver growth in AUM. In my first year as CEO, KIT has closed our largest transaction to date in the Middle East on an enterprise value basis, investing alongside some of the largest infrastructure investors globally such as BlackRock Real Assets and Hassanna Investment Company. This US$33 billion transaction was the largest energy infrastructure investment globally in 2021 and the largest energy infrastructure investment to date in EMEA. Our AUM growth target is $18 billion within the decade.

DG: One of the outcomes of the strategic review is that KIT has identified new key asset classes, which will benefit from secular growth trends. What does socio-economic infrastructure entail?

JC: As a corporate body, I strongly feel that there is a collective responsibility as an entity to invest and allocate capital in a responsible and sustainable manner. Economic profit is important, but at the same time, ESG factors are critical as well. Some of these new sectors that we have identified, such as renewable energy, are ones that we see favourable megatrends of decarbonisation, providing supportive tailwinds that we want to increase exposure to. When you think about socio-economic infrastructure, this encapsulates subsectors such as healthcare and education, which are similarly supported by strong demographics and underlying growth.

DG: As the Trust expands its business mandate due to its strategic review, would KIT's risk profile be significantly altered?

JC: We continue to be extremely disciplined in any of the opportunities that we pursue. When you look at our most recent investment in the Kingdom of Saudia Arabia, where together with a consortium, we acquired a 49% stake in the Kingdom's gas network, we are working with an operator which is one of the world's largest companies with decades of strong operational experience. When we looked at the risk allocation matrix for the transaction, we felt that this was an attractive opportunity with a compelling risk-adjusted return for a core midstream energy infrastructure asset. It was only after a thorough and extensive due diligence process with best-in-class consultants advising us, that ultimately got us comfortable with the long-term gas demand in the Kingdom. When you look at the production capacity mix in the Kingdom today, gas represents approximately 37%, with the balance largely being oil-based. As economies transition away from carbon-intensive hydrocarbons such as oil towards gas, we felt that this was a supportive trend as part of our investment thesis.

DG: KIT is asking Unitholders to increase Base Fee from $2.3 million to $20.4 million. Can the Trustee-Manager provide a breakdown of how the fees will be spent, and how much of the fees will go to the Trustee-Manager or sponsors' profits?

JC: It is important to look at the fees holistically – the existing fee structure is $2.3 million in Base Fees and $9.5 million in Performance Fees, which sum up to $11.8 million in total. The current bench strength is roughly 20, and we want to increase this to 40, and we are also in the process of launching our first offshore presence in Australia. We see strong compelling investment opportunities to support growth going forward.

DG: As DPU growth will be an integral component of the Performance Fees, why does management think that DPU growth is the best way to determine performance? Have you explored other options, such as DPU growth with a high-water mark or fee ceiling, or fee clawbacks?

JC: DPU growth is something that Unitholders have always been asking for, and we listen and strive to deliver this growth. As mentioned earlier, the proposed fee structure is one that has been widely adopted in the Singapore market. In terms of the ability to have a high-water mark, if we do not exceed our DPU of the preceding year, we will not receive a Performance Fee. We are always measured on a calendar year basis, which is also aligned with the market.

DG: The illustrative financial impact shows an increase in expenses. Apart from this, would there be other parts of KIT's financials be affected by this proposal to increase the fees? Can the increases in revenue and DPU commensurate with the increase in fee expenses?

JC: We want to emphasise our intention to grow DPU in a sustainable and prudent manner for the long-term. The circular illustrates a mechanical calculation, assuming the proposed fee structure was put in place, showing a direct reduction in DPU. There are different levers that we can utilize, as well as opportunities, such as the recent strategic review of Ixom that we announced, which allow us to potentially unlock value from the business and redeploy the proceeds into new assets and businesses. This gives us confidence to maintain the growth trajectory of our DPU in a sustainable and prudent manner, all for the benefit of Unitholders.

DG: Under the proposed fee structure, will management still have the option of being paid by way of issuance by KIT Units, or is this option removed to reduce the dilutive effect?

JC: This option will remain.

DG: Would you look at data centres, because there is Keppel DC REIT which has been very successful, and you are both under the Keppel family?

JC: It is highly unlikely that we will look at data centres as that is under the domain of Keppel DC REIT.

DG: Looks like there are other corporate actions that may indirectly affect DPU, such as Ixom, Basslink, and Bifrost. Do you have any fund-raising plans ahead?

JC: I would like to point out that we have not relied on Basslink for distributions ever since the inception of KIT in 2015. We do not see any impact on distributions that could arise from Bassslink as it was put into Voluntary Administration in November 2021, and operations are now under the control of the receiver and manager. As for Ixom, we announced the strategic review last month. We see a lot of potential to unlock latent value from Ixom and share some of this upside with Unitholders, and more importantly to recycle the capital and grow our cash flow profile by a substantial margin. I would urge Unitholders to look at the strategic review and the proposed fee amendment as a holistic package. For Bifrost, it is a potential asset, but it is under construction, therefore it is still a while away. Fund raising plans will depend on when a transaction materialises, but as of last year, we are very well-capitalised. As of end-2021, our gearing was 20.3% with more than $800 million of cash on the balance sheet, therefore there is ample balance sheet capacity to put to work prior to an equity fundraise.

DG: Are you exploring other inorganic investment opportunities, other than building capabilities.

JC: We do this rigorously at our portfolio companies and work closely with the respective management teams to further growth. You will see that at City Energy, the business has rebranded and transformed, and has entered into the electric vehicle charging sector. At Ixom, we are very proud that we have closed six bolt-on acquisitions since we acquired the business in 2019, which is testament to the strength of the platform for continued growth.

DG: With the proposed fee structure, is there still a need for acquisition fees?

JC: The proposed fee structure is in line with the market, and our peers have similar if not identical acquisition and divestment fees.

DG: How was Ernst and Young selected as the IFA?

EN: The role of the IFA is important. Hence, we only look for reputable firms to perform this role. In accordance with internal procurement policy, we sought several quotes and interviewed the respective teams. Ernst & Young came across as a party who is reputable and familiar with Business Trusts and SREITs.

DG: KIT has shared that the proposed fee structure is benchmarked to peers. Can you comment on your performance vis-à-vis your peers? Are the peers comparable to KIT?

JC: The reality is that there is no direct comparable to KIT in Singapore with a diverse portfolio of infrastructure assets and businesses globally. With that said, we have also benchmarked our fees to global infrastructure peers and results have shown that we are lower in terms of total fees when compared to them. We recognize that Unitholders perceive us as a YieldCo, and this is something that we will work hard to continue to deliver. When compared to the universe of REITs and Business Trusts in Singapore, you will see that the benchmarking shows that we are in line, based on a variety of metrics.

DG: Do you have any final comments, before we close this?

JC: Thank you David for hosting and moderating this session for us tonight, and we would like to thank all Unitholders for your time and support through the years. In closing, I would like to make a point that change is constant, as we have seen from the Covid-19 pandemic and the recent incursion of Ukraine at the geopolitical level. History is replete with examples of once-strong companies that have resisted change and failed to adapt as the winds of change blow, only to face dire consequences.

At KIT, we see a strong and bright future ahead of us. To enable and sustain the growth in years to come, I strongly urge Unitholders to carefully consider the proposed fee amendment that we have tabled. The existing asset base is a key stabilizing core of the portfolio, however there is a real need to continue to grow, rejuvenate and replenish the portfolio, as I have delivered with the recent acquisition in February 2022, with many other attractive investment opportunities that we have in the pipeline. The fee amendment will position the Trust with a strong footing to continue to deliver a strong, sustainable and resilient performance for many years to come, all for the benefit of Unitholders. Thank you.

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