

Independent Auditors' Report

Year ended December 31, 2017

Members of the Company
Sembcorp Industries Ltd

Report on the audit of the financial statements

Opinion

We have audited the financial statements of Sembcorp Industries Ltd (the "Company") and its subsidiaries (the "Group"), which comprise the consolidated balance sheets of the Group and the balance sheets of the Company as at December 31, 2017, the consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows of the Group for the year then ended, and notes to the financial statements, including a summary of significant accounting policies as set out on pages 158 to 320.

In our opinion, the accompanying consolidated financial statements of the Group and the balance sheets of the Company are properly drawn up in accordance with the provisions of the Singapore Companies Act, Chapter 50 (the "Act") and Financial Reporting Standards in Singapore ("FRSs") so as to give a true and fair view of the consolidated financial position of the Group and the financial position of the Company as at December 31, 2017 and of the consolidated financial performance, consolidated changes in equity and consolidated cash flows of the Group for the year ended on that date.

Basis for opinion

We conducted our audit in accordance with Singapore Standards on Auditing ("SSAs"). Our responsibilities under those standards are further described in the *Auditors' responsibilities for the audit of the financial statements* section of our report. We are independent of the Group in accordance with the Accounting and Corporate Regulatory Authority ("ACRA") *Code of Professional Conduct and Ethics for Public Accountants and Accounting Entities* ("ACRA Code") together with the ethical requirements that are relevant to our audit of the financial statements in Singapore, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the ACRA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Report on the audit of the financial statements *(cont'd)*

Impairment assessment of property, plant and equipment

(Refer to Notes 3 and 40 to the financial statements: S\$11,157,683,000)

Risk:

The Group's shipyard assets were subject to impairment test assessments, owing to the continuing difficult market conditions impacting the Group's offshore and marine sector.

The Group's largest yard assets and facilities are (i) the integrated yards, which include the individual yard locations in Singapore, the sub-contracting yards in Indonesia and the United Kingdom (the Singapore cash generating unit ("CGU")) and (ii) the yard in Brazil (Brazil CGU). Such shipyard assets are measured at cost less accumulated depreciation and impairment loss. An impairment loss exists when the net carrying amount of the shipyard assets is in excess of the fair value or recoverable amount. As the fair values of these shipyard assets are not readily determinable, the Group measures the recoverable amount using the discounted cash flow technique.

The determination of the recoverable amounts of these CGUs involves a high degree of judgement and is subject to significant estimation uncertainties, principally, the forecast order book. The forecast order book includes a diversified portfolio of long-term contracts whose initial contract pricing takes into account prevailing market conditions and the outlook of the oil and gas industry, which are inherently subject to estimation uncertainties.

As the Brazil CGU is not yet fully operational, and there is a limited track record of historical contract awards and performance, the Group has factored in the long term fundamentals of the oil and gas sector in Brazil to project the future order book. Accordingly, the future order book considers the projected capital expenditure of state-owned and international oil majors covering exploration and production projects that would lead to new build orders, regulations governing local content requirements, as well as forecast movements in oil prices in the foreseeable future projected by industry analysts. The long-term returns of the Brazil CGU, however, can also be significantly impacted by political risk.

The outcome of the shipyard assets impairment tests for the Singapore CGU and Brazil CGU reveals that the recoverable amounts are in excess of the net carrying amounts attributable to these CGUs.

Our response:

We assessed the Group's process for identifying and reviewing the CGUs subject to impairment testing.

We reviewed the key assumptions supporting the value-in-use calculations to arrive at the recoverable amounts of these CGUs. We compared the forecast order book to firm commitments secured from customers, management approved budgets built from the Group's past and actual experiences, prevailing industry trends, and industry analysts' reports. We compared the discount rates to market observable data including market and country risk premiums and any asset-specific risk premium.

We also reviewed available qualitative information from industry analysts, projected capital expenditure by oil majors supporting the projection of orders, and regulations on local content requirements. We assessed the related disclosures on key assumptions applied in determining the recoverable amounts of the CGUs.

Our findings:

The Group has a process for identifying and reviewing the CGUs for impairment testing. The impairment test assessments incorporated the relevant considerations. The disclosures describing the inherent degree of estimation uncertainty and the sensitivity of the assumptions applied are appropriate.

Independent Auditors' Report

Year ended December 31, 2017

Report on the audit of the financial statements *(cont'd)*

Recognition of revenue and recoverability of contract work-in-progress

(Refer to Notes 13, 25 and 40 to the financial statements: Contract work-in-progress of S\$1,841,647,000 and revenue of S\$8,345,605,000)

Risk:

One of the Group's significant revenue streams is derived from long-term construction contracts, in relation to ship building and conversion as well as infrastructure construction activities. The accounting for long-term construction contracts and the determination of percentage of completion is complex. Revenue is recognised based upon management's estimation of the value of the project activities completed. There are also estimation uncertainties associated with the costs to complete the projects. During the year, several contracts previously concluded with the original customers under modified terms (the "original contracts") were terminated, and re-sold to another customer (the "new contracts"), with relevant adjustments recorded. Such adjustments took into account the terms and conditions, including the contract prices and payment terms and delivery dates, stipulated in these new contracts.

As at the reporting date, there were also certain contracts subject to deferral in delivery or scope variations (the "contract modifications"). The contract provisions required involve management judgement.

In relation to certain contracts with customers that have filed for bankruptcy protection and are undergoing financial restructuring, revenues from these contracts continue to be suspended, with no additional adjustments recorded for the current year, following those contract provisions recorded in the previous years. As at the date of this report, the outcome arising from the bankruptcy protection filing and consequential restructuring remains a highly judgemental matter. Accordingly, there is a risk of a material adjustment to the carrying amounts of these contracts depending on events and circumstances that may occur in future periods.

The recoverability of amounts receivable from customers, contract work-in-progress on construction contracts, together with the corresponding contract revenues and costs recognised are therefore based on management's evaluation and best estimate of the ultimate realisation of these balances.

Our response:

- We reviewed the Group's estimation process (including the approval of project budget, monitoring of project costs and activities, and management's review and customer's approval of project's stage of completion and milestones achieved) used in determining the amounts of revenue and costs recognised in the Group's financial statements.
- We reviewed the original contracts and the reversal adjustments on revenue and cost of sales recorded on contract terminations.
- We reviewed the terms and conditions of new contracts, and the contract modifications to identify the relevant adjustments on revenue recognition and contract provisions.
- We reviewed the contractual terms and work status of the customer contracts, along with discussions with management and checked that contract revenue was recognised according to the percentage of completion of each project measured by the stage of completion of physical activities or by reference to the ratio of costs incurred to date to the estimated costs for each contract.
- We reviewed the re-forecast of each contract subject to any modifications and analysed current on-going negotiations and settlements that may impair the profitability of such contracts as well as the collectability of significant contracts by reference to the recent credit review assessment of each customer prepared by management.
- We assessed the adequacy of disclosures in describing the areas of judgement and estimation uncertainties involving revenue recognition and contract work-in-progress.

Report on the audit of the financial statements *(cont'd)*

Recognition of revenue and recoverability of contract work-in-progress *(cont'd)*

Our findings:

The Group has a process to determine the amounts of revenue and costs recognised in the financial statements.

We found that the measurement of percentage of completion used by the Group for revenue recognition appropriately reflects the status of and progress of the projects; and revenue was recognised only when collectability of the amounts was assessed by management to be probable.

The reversal adjustments on revenue and cost of sales on those terminated contracts were according to the terms of the original contracts.

The relevant adjustments on revenue and contract provisions for the new contracts and contracts with modifications were appropriately considered.

The judgements applied on those contracts belonging to customers undergoing financial restructuring were within an acceptable range of considerations, taking into account the facts and circumstances currently made available to the Group.

We found the disclosures in describing the areas of judgement and inherent degree of estimation uncertainties involved, to be appropriate.

Valuation of goodwill

(Refer to Note 11 and 40 to the financial statements: S\$197,194,000)

Risk:

At 31 December 2017, the Group's balance sheet includes goodwill amounting to S\$197 million, predominantly allocated to six cash generating units (CGUs). The determination of the recoverable value of goodwill involves significant estimation uncertainties in relation to the cash flows from the respective CGUs and the underlying assumptions to be applied. The cash flows are sensitive to key assumptions relating to discount rates, long-term growth rates as well as profitability of the CGUs based on existing market conditions.

Our response:

We reviewed the key assumptions relating to the estimated future cash flows of each CGU by considering historical performance against budgets, discussions with management and our understanding of future conditions. We also compared the long-term growth rates and discount rates for each CGU to available industry data. We also considered the disclosures in describing the inherent degree of estimation uncertainty and key assumptions applied.

Our findings:

We found the key assumptions to be supported by market data and management's expectations of future conditions and the disclosures to be appropriate in describing the inherent degree of estimation uncertainty and key assumptions applied.

Independent Auditors' Report

Year ended December 31, 2017

Report on the audit of the financial statements *(cont'd)*

Litigation, claims and other contingencies

(Refer to Note 37 to the financial statements)

Risk:

The Group is subject to operational, business and political risks in some of the countries in which it operates. These risks could give rise to litigation, claims and other contingencies (collectively, the "contingencies") which could have a significant financial impact if the potential exposures were to materialise. Ad-hoc Committees / Taskforces, if formed for any specific purpose, may conduct independent investigations on allegations that have potential impact on the business and the Group's financial statements, and recommend decisions as considered appropriate in connection with the independent investigations.

The determination by management of whether, and how much, to provide and / or disclose for such contingencies is highly judgemental.

Our response:

We assessed the Group's process for identifying and monitoring significant adverse developments arising from contingencies and where appropriate, legal, regulatory and political developments. We have reviewed the terms of reference of Ad-hoc Committees formed.

We evaluated management's assessment of the likely outcome and potential exposures arising from all significant contingencies and allegations subject to on-going investigations; and considered the requirements for any provision and related disclosures. Our work included:

- Assessment of the progress of all significant contingencies, including reviewing the Group's public announcements and the underlying basis for the announcements made;
- Consideration of any evidence of legal disputes which we were made aware;
- Holding discussions with management, the Group's in-house legal counsel and members of the Ad-hoc Committees / Taskforce, and reviewing pertinent correspondence between the parties involved and relevant reports issued by third parties;
- Obtaining independent legal confirmation letters from and discussing with the Group's external lawyers handling these issues to confirm the fact patterns which we have been advised; and
- Involvement of specialists to look into any on-going investigation work commissioned by the Ad-hoc Committees to support management's conclusions.

Our findings:

We found that the Group has a process for identifying and monitoring potential exposures arising from legal, regulatory and political developments as well as determination of the appropriate measurement and / or disclosures of such contingencies in the Group's financial statements. From our audit procedures performed, we found the liabilities recognised and disclosures on contingencies to be appropriate.

Report on the audit of the financial statements *(cont'd)*

Other Information

Management is responsible for the other information contained in the annual report. Other information is defined as all information in the annual report other than the financial statements and our auditors' report thereon.

We have obtained the following items prior to the date of this auditors' report:

- Group FY2017 Highlights
- Chairman and CEO's Statement
- Our Group Strategy
- Our Utilities Strategy
- CEO Interview
- Group Financial Review
- Utilities Review
- Marine Review
- Urban Development Review
- Directors' Statement

The following items (the "Reports") are expected to be made available to us after that date:

- Sembcorp at a Glance
- Our Leadership
- Environmental, Social and Governance Review
- Supplementary Information
- EVA Statement
- Shareholders' Information
- Governance Disclosure Guide
- Corporate Information
- Financial Calendar

Our opinion on the financial statements does not cover the other information and we do not and will not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information that we obtained prior to the date of this auditors' report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

When we read the Reports, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance and take appropriate actions in accordance with SSAs.

Independent Auditors' Report

Year ended December 31, 2017

Report on the audit of the financial statements *(cont'd)*

Responsibilities of management and directors for the financial statements

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with the provisions of the Act and FRSs, and for devising and maintaining a system of internal accounting controls sufficient to provide a reasonable assurance that assets are safeguarded against loss from unauthorised use or disposition; and transactions are properly authorised and that they are recorded as necessary to permit the preparation of true and fair financial statements and to maintain accountability of assets.

In preparing the financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

The directors' responsibilities include overseeing the Group's financial reporting process.

Auditors' responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SSAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with SSAs, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

Report on the audit of the financial statements *(cont'd)*

Auditors' responsibilities for the audit of the financial statements *(cont'd)*

We communicate with the directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the directors with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the directors, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

Report on other legal and regulatory requirements

In our opinion, the accounting and other records required by the Act to be kept by the Company and by those subsidiary corporations incorporated in Singapore of which we are the auditors have been properly kept in accordance with the provisions of the Act.

The engagement partner on the audit resulting in this independent auditors' report is Ling Su Min.



KPMG LLP
Public Accountants
and Chartered Accountants

Singapore
February 28, 2018