

Independent Auditors' Report

Year ended December 31, 2019

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 sheet of the Group and the balance sheet of the Company as at December 31, 2019, 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 128 to 270.

In our opinion, the accompanying consolidated financial statements of the Group and the balance sheet of the Company are properly drawn up in accordance with the provisions of the Singapore Companies Act, Chapter 50 (the Act), Singapore Financial Reporting Standards (International) (SFRS(I)s) and International Financial Reporting Standards (IFRSs) 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, 2019 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.

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

Impairment assessment of property, plant and equipment, right-of-use assets and intangible assets – comprising goodwill, long-term contracts, design under development and intellectual property rights only (collectively, the shipyard and utilities non-financial assets)

(Refer to Notes D1, D2 and D4 to the financial statements: property, plant and equipment of S\$11,739,000,000, right-of-use assets of S\$464,000,000, goodwill of S\$209,000,000, long-term contracts of S\$132,000,000, design under development of S\$50,000,000 and intellectual property rights of S\$185,000,000)

Risk:

The Group's shipyard and utilities non-financial assets were subject to impairment test assessments, owing to the continued challenging market conditions impacting the Group's offshore and marine and utilities sectors. The Group's key 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)) (ii) the yard in Brazil (Brazil CGU) (iii) the utilities assets in China, India, Singapore and United Kingdom (UK).

At December 31, 2019, the Group's balance sheet includes goodwill amounting to S\$209,000,000, predominantly allocated to six CGUs in the Energy segment. Goodwill is reviewed for impairment at least annually and as and when indicators of impairment occur.

An impairment loss exists when the net carrying amount of the assets is in excess of the recoverable amount. The recoverable amount of a CGU is the higher of the CGU's fair value less costs of disposal and its value-in-use (VIU). As the fair values of these assets are not readily determinable, the Group measures the recoverable amount using the discounted cash flow technique to derive the assets' VIU.

The determination of the recoverable amounts of these CGUs involves a high degree of judgement and is subject to significant estimation uncertainties, principally, the discount rates, the forecast order book (shipyards) as well as market demands, gross margin forecasts, plant load factors (power plants) and wastewater plant treatment capacity (wastewater treatment assets). The forecast order book includes a diversified portfolio of long-term contracts whose contract pricing takes into account prevailing market conditions and the outlook of the oil and gas industry, while the gross margin forecasts, plant load factors and wastewater plant treatment capacity take into account expected customer demand and forecasted tariff rates. These are inherently subject to estimation uncertainties as well as political and regulatory developments.

As the Brazil CGU is not yet fully operational, and there is 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 can also be significantly impacted by political risk.

Arising from the continued challenging economic and market conditions in the UK, an impairment loss totalling S\$178,000,000 was recognised on UK Power Reserve assets in 2019 to write down the carrying amount of these assets to their estimated recoverable amounts. In addition, following an assessment of the wastewater plants' efficiency and effectiveness in meeting the new and more stringent effluent discharge standards that will come into force in Jiangsu, China in 2021, a review of recoverable amount of the related assets was performed and an impairment loss of S\$23,000,000 was recognised. The outcome of the remaining impairment tests on the shipyard assets for the Singapore CGU, Brazil CGU and the utilities' CGUs located in China, India and Singapore shows that the recoverable amounts are currently in excess of the net carrying amounts attributable to these CGUs as at the reporting date.

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

Impairment assessment of property, plant and equipment, right-of-use assets and intangible assets – comprising goodwill, long-term contracts, design under development and intellectual property rights only (collectively, the shipyard and utilities non-financial assets) *(cont'd)*

Our response:

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

We, including our valuation specialists to the extent appropriate, 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 plant load factors and gross margin forecasts to what has been achieved historically, as well as prevailing industry trends. 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 known relevant considerations as at the reporting date. The disclosures describing the inherent degree of estimation uncertainty and the sensitivity of the assumptions applied are appropriate. If unfavourable changes to these assumptions occur, this could lead to lower operating cash inflows and impairment outcomes which may in turn affect the financial position and performance of the Group.

Recognition of revenue and recoverability of trade receivables and contract balances in relation to contracts with customers in the Marine segment

(Refer to Note B2 to the financial statements: Turnover of S\$2,881,000,000)

(Refer to Notes B2(c) and E1 to the financial statements: Trade receivables of S\$1,436,000,000, Contract assets of S\$1,462,000,000 and Contract costs of S\$89,000,000)

Risk:

One of the Group's significant revenue streams is derived from long-term construction contracts in relation to ship building and conversion.

In accordance with SFRS(I) 15 *Revenue from Contracts with Customers*, the analysis of whether these contracts comprise one or more performance obligations, and whether the performance obligations are satisfied over time or at a point in time, are areas requiring critical judgement by the Group.

The Group accounts for revenue recognised over time from long-term construction contracts based on the percentage of completion method, which involves estimation uncertainties around the stage of physical activities completed as well as costs to complete the contracts.

Owing to the continued difficult market conditions impacting the offshore and marine sector, the recoverability of trade receivables and contract balances in relation to contracts with customers is inherently judgemental. In accordance with SFRS(I) 9 *Financial Instruments*, the Group is required to recognise loss allowances on expected credit losses on financial assets and contract assets. The determination of the loss allowances requires significant judgement and estimates to determine whether the financial asset is credit impaired, and the best estimate of the ultimate realisation of the amounts receivable from customers and contract assets from customer contracts.

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

Recognition of revenue and recoverability of trade receivables and contract balances in relation to contracts with customers in the Marine segment *(cont'd)*

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 of the project's stage of completion and milestones achieved with customers) used in determining the amounts of revenue recognised in the financial statements as well as in relation to determining the amounts of loss allowance recognised on the financial assets and contract assets.
- We reviewed the terms and conditions of contracts, including contract modifications, discussed with management, to assess if management's identification of performance obligations and timing of revenue recognition is appropriate.
- We reviewed the contractual terms and work status of the projects, 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.
- We reviewed the credit review assessment prepared by management for the customers with significant new contracts, and we analysed current on-going negotiations and settlements of significant contracts subject to modifications, to identify if the collectability of contract consideration is probable.
- We reviewed the significant inputs to management's assessment of the amounts of loss allowance recognised on expected credit losses, and considered the reasonableness of the inputs by reference to the recent credit review assessments prepared by management.
- We reviewed the re-forecast of each significant contract and enquired with management on any current on-going negotiations that may impair the recoverability of significant receivables and contract balances.
- We assessed the adequacy of disclosures in describing the areas of judgement and estimation uncertainties involving revenue recognition.

Our findings:

The Group has processes to determine the amounts of revenue recognised in the financial statements as well as to assess credit risk and determine the amount of credit loss allowance to be recognised on trade receivables and contract assets.

We found the basis of identifying the performance obligations and timing of satisfaction of performance obligations to be appropriate.

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 judgements applied by management around the recovery of receivables and contract balances, as well as those contracts belonging to customers undergoing financial restructuring, were relevant under 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.

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

Litigation, claims and other contingencies

(Refer to Note C8 to the financial statements)

Update in relation to investigations of "Operacao Lava Jato" (Operation Car Wash)

(Refer to Note H7 to the financial statements)

Risk:

The Group is subject to operational, business and political risks in 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.

Update in relation to Operation Car Wash

In 2019 and 2020, the Group's subsidiary, Sembcorp Marine Ltd (SCM) has made announcements in relation to ongoing investigations related to Operation Car Wash in Brazil. These investigations involved allegations in Brazil of illegal payments made by Mr Guilherme Esteves De Jesus (GDJ) whom is connected to the consultant engaged by the subsidiaries of SCM, and acts of money laundering and corruption performed by GDJ and Mr Martin Cheah Kok Choon, former president of Estaleiro Jurong Aracruz Ltda, a subsidiary of SCM. Since 2015, SCM had formed an Ad-hoc Committee to conduct independent investigations on the allegations for potential impact on the business and the SCM Group's financial statements, and recommend decisions as considered appropriate in connection with the independent investigations. As at the date of the financial statements, investigations are still ongoing and the directors for SCM have determined that it is premature to predict the eventual outcome of this matter.

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 provisions and related disclosures. Our work included:

- Holding discussions with management, the Group's legal counsel, the Audit Committee and the Ad-hoc Committee, and reviewing relevant documents;
- Assessment of the progress of all significant contingencies, including reviewing the Group's public announcements;
- Consideration of any evidence of legal disputes which we were made aware;
- Obtaining independent legal confirmation letters from and discussing with the Group's external lawyers to confirm the facts which we have been advised;
- Inquiries with the SCM Group's external legal counsel, together with our specialists, to understand the scope, approach and status of the Operation Car Wash investigations, and to confirm the facts which we have been advised; and
- Assessed the adequacy of disclosures in the financial statements in respect of this matter.

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

Litigation, claims and other contingencies *(cont'd)*

Update in relation to investigations of "Operacao Lava Jato" (Operation Car Wash) *(cont'd)*

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 on such contingencies in the Group's financial statements.

From our audit procedures performed and representations obtained from management / Ad-hoc Committee representations, we found the liabilities recognised, where applicable, and disclosures on such contingencies in respect of the Operation Car Wash to be appropriate.

Acquisition of subsidiary and intellectual property rights

(Refer to Note G2 to the financial statements: Intangible assets of S\$61,000,000, Negative goodwill of S\$5,000,000 and Goodwill of S\$1,000,000)

Risk:

In 2018, the Group acquired a subsidiary and intangible rights from Sevan Marine ASA (Sevan Marine). With the acquisition, the litigation between the Group and Sevan Marine relating to an infringement of intellectual property rights of the Group was also terminated.

In 2019, the Group completed its valuation and purchase price allocation exercise. Judgement is required in determining the allocation of the purchase price. In accounting for a business combination, estimates are also required in measuring the fair value of identifiable assets acquired and liabilities assumed, and settlement of the litigation.

Our response:

- We assessed the competency and objectivity of the independent professional firm that assisted management in the valuation and purchase price allocation exercise.
- We reviewed management's assessment of the purchase price allocation, reviewed the valuation technique adopted and significant inputs to the valuation model and performed a re-computation of the negative goodwill derived by management.
- We assessed the adequacy of disclosures in describing the areas of judgement and estimate in determining the allocation of the purchase price and measurement of the fair value of the identifiable assets acquired and liabilities assumed.

Our findings:

The judgements applied by management in the allocation of the purchase price and the estimates by management used in the valuation of the respective assets acquired and liabilities assumed were found to be fair. We found the disclosures in describing the areas of judgement and inherent degree of estimation uncertainties involved, 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 FY2019 Highlights
- Chairman and CEO's Statement
- Group Financial Review
- Energy Review
- Marine Review
- Urban Review
- Directors' Statement

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

- Our Value Creation Process
- Our Leadership
- Environmental, Social and Governance Review
- Supplementary Information
- Shareholding Statistics
- Additional Information on Directors Seeking Re-election
- Corporate Information

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, 2019

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, SFRS(I)s and IFRSs, 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 Koh Wei Peng.



KPMG LLP

Public Accountants and
Chartered Accountants

Singapore

March 4, 2020