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Falcon Energy Group Limited

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Company Update

Next Target Spotted

Update: On 8th Feb 2010, Falcon Energy Group Limited (Falcon) announced a proposed acquisition for 29.07% of Scomi Marine Services Pte Ltd.'s stake in CH Offshore Ltd. (CHO)

CHO is an offshore support vessel operator with a fleet of 11 Anchor Handling Tug Supply (AHTS) vessels and co-owns two AHTS vessels with Scomi Marine Berhad (SMB).

The proposed acquisition is valued at S\$143.5m to be paid entirely in cash by the group. The per share acquisition price is S\$0.70, representing a 8.5% premium relative to present price of S\$0.645.

Financing the acquisition: Falcon had prepared a pro forma financial position of their Group following the proposed acquisition. (Refer to Appendix 1)

From the financial figures given, management intends to fund 20% of the acquisition (approximately US\$20m) using cash and cash equivalents and finance the remaining balance (approximately US\$80m) via borrowings and loans.

Our analysis: We like this acquisition because

- 1) We do not anticipate any cannibalization of business between both parties. CHO offers an alternative service of AHTS chartering, which is different from Falcon's main business of being a production and supply vessels charterer
- 2) Beneficial cross-business opportunity may arise for both parties as they operate within the same industry
- 3) CHO has strong balance sheet, young vessels along with good profitability. We expect this newly acquired associate to contribute meaningfully to the group's

Increase Exposure

Intrinsic Value S\$1.01
Prev Closing Price S\$0.685

Main Activities

Falcon is an investment holding company which offers a spectrum of services from exploration and drilling phase to the post production stage. The business is divided into three segments: Marine, Oilfield Service and Oilfield Project.

Financial Highlights

(Y/E Dec) US\$m	FY08-15 mths	FY09F*	FY10F
Revenue	73.8	76.8	99.8
Gross Profit	41.6	42.5	54.4
Net Profit	36.1	32.8	50.4
EPS (US cts)	5.15	4.35	6.19

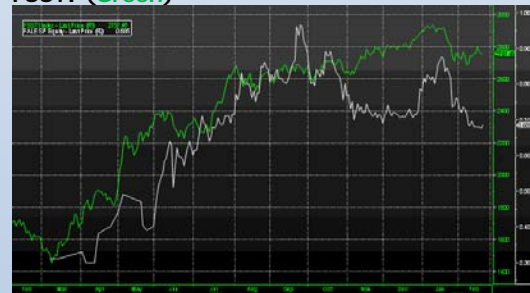
*: Excludes income from CHO
Source: Company, SIAS Research

Key ratios (FY10F)

PER	7.9
P/BV	1.5
ROA	15.4%
ROE	21.6%
Debt to Equity	42.6%
Current ratio	1.02

Source: SIAS Research

Indexed Price Chart Falcon Energy (White) FSSTI (Green)



Source: Bloomberg

52wks High-Low S\$0.990/0.300
Number of Shares 814.1 m
Market Capitalization S\$557.7m

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bottom line going forward via the share of profit of associate.

Our concern: However, we remain doubtful about Falcon's ability to raise an additional US\$80m in borrowings for the acquisition. In particular, the management projects gross gearing to increase to 67% from 20% after the acquisition, which we believe is too high. Hence, there may be a need for Falcon to supplement the deficient amount by means of:

- 1) Tapping onto the S\$50m raised through the Sep 2009 placement for the acquisition of support vessels
- 2) Issuance of additional shares through placement

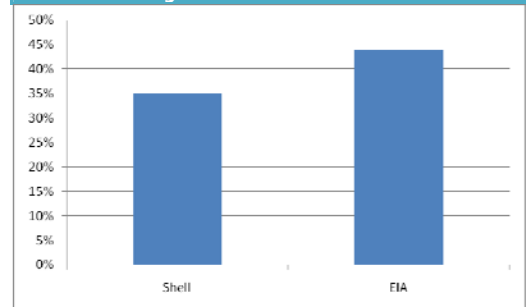
Industry outlook: The global economy is likely to recuperate during 2010. Several industry experts have also anticipated strong energy demand going forward, with ExxonMobil forecasting a 35% jump in energy consumption from 2005 to 2030 and Energy Information Administration (EIA) predicting a stronger 44% hike from 2006 to 2030.

Global capital expenditure (CAPEX) is also likely to improve as we continue to receive CAPEX adjustment news from big integrated companies such as CNOOC and Santos which plan to increase capital investment by 29.5% and nearly double for the latter. Hence, we maintain our favorable outlook on the asymmetrical offshore service subsector.

Valuation: Following the announcement of the proposed acquisition and possible expansion from the proceeds raised through the Sep 2009 placement, Falcon is on its way to realize bulk of the growth we had previously forecasted into the company.

Earnings are likely to be inflated subsequent to the completion of the above deals. However, the balance sheet of the group seems to be slightly overstretched and is likely to increase Falcon's borrowing cost from banks. Hence, we increase the cost of debt to 6.5%, from 6% previously. With that, we arrive at an intrinsic value of S\$1.01 and maintain our **Increase Exposure** call on Falcon Energy.

Figure 1: Growth in energy demand by 2030.



Source: ExxonMobil, EIA

Figure 2: Economic Profit Valuation

S\$ '000	2008-15 mths	2009F	2010F	2011F	2012F	2013F
EBIT	37918	35447	56407	63721	68838	71802
Tax on EBIT	-670	-886	-1692	-2549	-3442	-5026
Deferred Tax Liability	-62	-84	-156	-228	-311	-458
NOPLAT	37186	34477	54559	60945	65085	66318
Total Invested Capital		125233	143710	341177	366076	411201
WACC		9.1%	8.9%	9.0%	9.1%	9.2%
Capital Charge		11399	12749	30709	33351	37935
Economic Profit		23077	41809	30236	31733	28383
Terminal						469584
Discount Rate		1.00	0.93	0.85	0.78	0.71
Present Value		23077	38813	25751	24770	20283
Book Value		106785				
Explicit Value		132693		Risk Free	2.5%	
Terminal Value		335577		MRP	7.5%	
Value of Firm		575055		Cost of Equity	10.00%	
Number of Shares		814100		Cost of Debt	6.5%	
Value per Share (US\$)		0.71		Terminal G	3.0%	
US Dollar Conversion		1.43		WACC	9.4%	
Value in S\$		1.01				

Source: SIAS Research Estimate

Appendix 1: Financial Assumption of Proposed Acquisition

6.4 Net tangible assets

	Before the Longzhu Acquisition and the Placement Issue and the Proposed Acquisition	After the Longzhu Acquisition but before the Placement Issue and the Proposed Acquisition	After the Longzhu Acquisition and the Placement Issue but before the Proposed Acquisition	After the Longzhu Acquisition and the Placement Issue and the Proposed Acquisition
NTA (US\$'000)	106,785	106,976	148,232	164,581
Total number of shares in the Company's issued and paid-up share capital	710,418,754	734,134,970	814,134,970	814,134,970
NTA per share (US Cents)	15.03	14.57	18.21	20.22

6.5 Gearing

	Before the Longzhu Acquisition and the Placement Issue and the Proposed Acquisition	After the Longzhu Acquisition but before the Placement Issue and the Proposed Acquisition	After the Longzhu Acquisition and the Placement Issue but before the Proposed Acquisition	After the Longzhu Acquisition and the Placement Issue and the Proposed Acquisition
Total borrowings (US\$'000)	28,403	29,425	29,425	110,829
Cash & cash equivalent (US\$'000)	10,271	16,571	57,828	37,828
Shareholders' funds (US\$'000)	106,785	106,976	148,232	164,581
Gross gearing (times)	0.27	0.28	0.20	0.67
Net gearing (times)	0.17	0.12	Not applicable ⁽²⁾	0.44

Source: SGX Website, Falcon

Figure 3: Financial Figures and Ratios							
US\$ '000	2007	2008-15 mths	2009F	2010F	2011F	2012F	2013F
Revenue	38582	73838	76792	99829	117798	135468	149015
Gross Profit	20844	41555	42466	54407	63611	70443	74507
Net Income Before Taxes	18455	36759	33654	51928	56965	62255	65383
Net Income After Taxes	17372	36109	32813	50370	54686	59142	60806
Total Current Assets	23045	31376	123501	53257	83372	102518	125191
Total Non-Current Assets	72633	127173	140812	337404	360736	404772	442981
Total Current Liabilities	14089	30592	28510	52138	55289	59640	63930
Total Non-Current Liabilities	9065	21172	27499	80024	76017	76010	72203
Total Equity	72524	106785	208304	258499	312802	371640	432039
Net Income Before Tax	17625	36759	33654	51928	56965	62255	65383
Cash from Operating Activities	7502	52301	34713	47147	54837	59696	63561
Cash from Investing Activities	-34213	-52707	-18653	-189759	-18419	-39055	-33695
Cash from Financing Activities	26045	7240	75575	68664	-12267	-6594	-11654
Net Change in Cash	-666	6834	91635	-73948	24152	14047	18212
Net Cash - Beginning Balance	3182	2518	9363	100978	27004	51126	65140
Net Cash - Ending Balance	2518	9363	100978	27004	51126	65140	83317
Inventory Days		12	8	8	8	9	9
Receivable Days		117	94	78	79	82	86
Payable Days		238	222	162	160	157	160
ROE		32.2%	20.8%	21.6%	19.1%	17.3%	15.1%
ROA		22.7%	15.5%	15.4%	13.1%	12.4%	11.3%
Debt/Equity		26.5%	17.7%	42.6%	33.4%	28.1%	23.0%
Current Ratio		1.03	4.33	1.02	1.51	1.72	1.96
P/E		9.4	11.2	7.9	7.2	6.7	6.5
P/B		3.2	1.8	1.5	1.3	1.1	0.9

Source: SIAS Research Estimate

Definition:

Increase Exposure – The current price of the stock is significantly lower than the underlying fundamental value of the firm. Readers can consider increasing their exposure in their portfolio to a higher level.

Invest – The current price of the stock is sufficiently lower than the underlying fundamental value of the firm. Readers can consider adding this stock to their portfolio.

Fairly Valued – The current price of the stock is reflective of the underlying fundamental value of the firm. Readers may not need to take actions at current price.

Take Profit – The current price of the stock is sufficiently higher than the underlying fundamental value of the firm. Readers can consider rebalancing their portfolio to take advantage of the profits.

Reduce Exposure - The current price of the stock is significantly higher than the underlying fundamental value of the firm. Readers can consider reducing their holdings in their portfolio.

DISCLAIMER

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As of the date of the report, the analyst and his immediate family do not hold positions in the securities recommended in this report.

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