

## Falcon Energy Group

### Soaring To Greater Heights

**Update:** On 14 August 2010, Falcon Energy Group (Falcon) announced their 2Q 2010 results. 1H 2010 revenue and profit rose 33.5% and 32.5% YoY respectively. We had previously projected FY10F revenue and profit to climb 23.5% and 54.5% respectively. Whilst we remain positive about the company, we are adjusting our forecasts slightly downward (FY10F revenue and profit to grow by 18% and 39% respectively) for conservative reasons.

#### Fundamental Drivers:

- Project Division Headed The Results:** 1H 2010 marine division revenue grew 28.1% YoY, driven by larger fleet size whereas project division revenue spiked one-fold as the operations only officially commenced in 3Q 2009.
- 1H 2010 gross margin inched 1.5% points to 50.9% owing to better gross margin from the marine and oilfield divisions, which improved 1.2% points and 2.8% points respectively.
- 1H 2010 administrative expenses increased 40.7% YoY due to higher revenue while finance costs grew US\$1.77m across the same period, as a result of bank charges incurred for the purchase of 29.07% stake in CH Offshore Limited. Falcon has approximately S\$105m borrowings and assuming an interest rate of 4.5%, we project quarterly financing expenses to be roughly US\$1.2m.
- More From The Associates:** Following the CH Offshore deal, the associates contributed US\$1.7m for 2Q 2010 and we expect this figure to grow, as Falcon only recognized 2 months of CH Offshore earnings – the deal was sealed in late April 2010.

#### Value Catalyst:

We anticipate Falcon to ride on the industry trends and maintain its growth. Based on our revised projections, our model suggests an intrinsic value of S\$0.900 per share. Maintain **Increase Exposure**.

## Increase Exposure

- Intrinsic Value S\$0.900
- Prev Closing S\$0.535

#### Main Activities

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

#### Financial Highlights

(Y/E Dec) US\$'mn	FY09	FY10F	FY11F
Revenue	89.2	105.3	121.1
Gross Profit	38.9	52.6	60.5
Net Profit	29.4	40.9	44.5
EPS (US cts)	3.75	4.77	5.20

Source: SIAS Research Estimate

#### Key ratios (FY10F)

PER	8.3
P/BV	1.6
ROE	21.8%
Debt/Equity	60%
Current ratio	1.65

Source: SIAS Research Estimate

#### Indexed Price Chart

Green (FSSTI)  
White (Falcon)



Source: Bloomberg

52wks High-Low	99.0 cents/48.0 cents
Number of Shares	814.1 m
Market Capitalization	S\$439.6 m

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**Soaring To Greater Heights:** We expect the oilfield project division to be the main driver for 2H 2010 and anticipate contributions from associates to increase, as the company gets to recognize full contribution from CH Offshore. Both factors are likely to push Falcon’s profit to greater heights.

Falcon is optimistic about the industry prospect for the short to medium term, and intends to double its existing fleet over the next few years, and across new regions.

We anticipate the company to finance the growth via both debt and equity – Falcon may be able to secure 60-70% loan for each project. The balance sheet stood at a healthy position of 55% debt/equity for 2Q 2010. We reckon the company can lever up to 80-90% range, if necessary.

**With Favorable Industry Outlook:** Crude oil prices remain encouraging and global offshore O&G spending is projected to grow from 2009 to 2013F. We continue to be bullish on the industry fundamental and believe Falcon is well positioned to hitch on the trend.

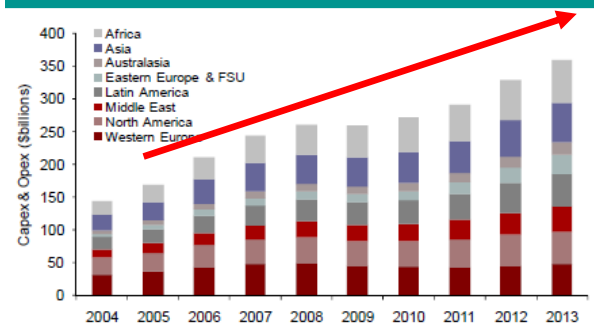
**Valuation:** We project Falcon’s FY2010F revenue and profit to grow by 18% and 39% respectively. Our model suggests an intrinsic value of S\$0.900 per share, representing an upside of 68.2%. Recommend **Increase Exposure.**

Figure 1: Crude Oil Prices



Source: Bloomberg

Figure 2: Global Offshore O&G Spending



Source: EnergyFiles

Figure 3: Economic Profit Model

US\$ '000	2008-15 mths	2009F	2010F	2011F	2012F	2013F
EBIT	37918	31435	46513	51779	57670	59824
Tax on EBIT	-670	-888	-1395	-2071	-2883	-4188
Deferred Tax Liability	-62	-616	-126	-186	-261	-381
Minority Interest			-2043	-2226	-2483	-2531
NOPLAT	37186	29931	42948	47296	52042	52725
Total Invested Capital			164949	296865	317584	350525
WACC			8.6%	8.7%	8.8%	8.9%
Capital Charge			14161	25761	27953	31177
Economic Profit			28786	21536	24089	21548
Terminal						376528
Discount Rate			0.98	0.90	0.83	0.76
Present Value			28200	19412	19957	16394
Book Value			173875			
Explicit Value			83963		Risk Free	2.5%
Terminal Value			286466		MRP	7.5%
Value of Firm			544303		Cost of Equity	10.00%
Number of Shares			814100		Cost of Debt	6.5%
Value per Share (US\$)			0.669		Terminal G	3.0%
US Dollar Conversion			1.35		WACC	9.4%
Value in S\$			0.90			

Source: SIAS Research Estimates

**Figure 4: Financial Forecasts and Estimates**

US\$ '000	2009	2010F	2011F	2012F	2013F
Revenue	89205	105262	121051	136788	150467
Gross Profit	38884	52631	60526	68394	72224
Net Income Before Taxes	30300	42127	46379	52270	54424
Net Income After Taxes	29440	40863	44524	49656	50614
Total Current Assets	87654	79079	98983	112422	130189
Total Non-Current Assets	132446	254733	269542	294516	316524
Total Current Liabilities	28214	47995	58022	61788	66108
Total Non-Current Liabilities	12229	85516	80509	80502	80495
Total Equity	173875	200301	229994	264649	300110
Net Income Before Tax	30300	42127	46379	52270	54424
Cash from Operating Activities	21160	39926	52318	56714	59167
Cash from Investing Activities	-31633	-126183	-18839	-29646	-27440
Cash from Financing Activities	48150	76303	-18530	-18530	-18530
Net Change in Cash	37677	-9954	14950	8539	13198
Net Cash - Beginning Balance	9363	47054	37075	51994	60500
Net Cash - Ending Balance	47054	37075	51994	60500	73663
Inventory Days	4	5	6	6	6
Receivable Days	119	135	126	124	123
Payable Days	129	84	85	98	103
ROE	21.0%	21.8%	20.7%	20.1%	17.9%
ROA	15.6%	14.6%	12.5%	12.6%	11.6%
Debt/Equity	15.1%	59.9%	52.2%	45.3%	40.0%
Current Ratio	3.11	1.65	1.71	1.82	1.97
P/E	10.6	8.3	7.6	6.8	6.7
P/B	1.7	1.6	1.4	1.2	1.1

Source: SIAS Research Estimates

**Rating Definition:**

**Increase Exposure** – The current price of the stock is significantly lower than the underlying fundamental value 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.

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**IMPORTANT DISCLOSURE:**

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