

## Falcon Energy Group Limited

### Poised for Turnaround in FY2016

Falcon reported a net PATMI of US\$22.7m for FY15 ended 31 March 2015. The dampened performance, especially in the fourth quarter, largely coincided with challenging conditions brought about by the decline of oil prices. With the completed acquisition of CH Offshore (CHO) on 27 February 2015, Falcon now holds 86.7% majority stake in the new subsidiary. Along with improving conditions from higher oil prices, we remain optimistic of Falcon's long term prospects going forward.

**Revenue and Top Line within Expectations:** Falcon revenue fell by 2.4% from US\$350.8 in FY14 to US\$342.4m in FY15, and was 4.4% lower from our forecast of US\$357.5m. Contribution from the Marine Division in the fourth quarter was US\$12m versus our forecast of US\$20.0m, resulting in the difference. Falcon's gross profit for FY2015 was US\$51.4m and was within our expectation of US\$51.8m.

**Operating Profit Dampened due to One-Off Losses:** PATMI for FY15 was US\$22.7m versus our forecast of US\$38.8m (41.5% deviation). The difference was mainly attributed to one-off items such as, US\$2.7m trade debts written off, legal fees of US\$3m for the acquisition as well as losses on deemed disposal of previously held interest in associate and subsidiaries, which amounted to US\$11.1m. Were these costs not incurred, PATMI would have been nearer to our expectation at US\$39.5m. FY15 net cash flow from operating activities was positive at US\$94.5m.

**Brighter Horizon in FY2016 and beyond:** Oil prices had generally recovered to higher levels since hitting rock bottom of US\$48.48 per barrel (WTI Crude Spot Price) in March 2015. As of 8 June 2015, spot oil price had picked up to about US\$58.56 per barrel. Higher oil prices will present better stability in the oil and gas industry. Going forward, we expect the better conditions will translate to better prospects for Falcon in terms of revenue and margin. In addition, having just recently acquired CHO, Falcon still has room for cost reduction by eliminating certain duplicity. For instance, the centralization of office space between CHO and Falcon's marine division can reduce rental and administrative expenses.

## Increase Exposure

- Intrinsic Value S\$0.555
- Prev Close S\$0.275

### Main Activities

Falcon is an investment holding company which offers a spectrum of services from exploration and drilling phase to post production stage. The business is divided into three segments: Marine, Oilfield Services and Oilfield Projects. The Resources division and Drilling Services division were established more recently.

### Financial Highlights

(Y/E Mar)US'm	FY14	FY15	FY16
Revenue	350.8	342.4	375.0
Gross Profit	117.0	51.4	75.0
PATMI	60.8	22.7	24.5
EPS (US cts)	7.5	2.8	3.0

Source: Voyage Research Estimates

### Key ratios (FY16F)

PER	6.7
P/BV	0.50
ROE	9.1%
Gross Debt/ Gross Equity	106.1%
Current ratio	1.2

Source: Voyage Research Estimates

### Indexed Price Chart

Green (FSSTI)

Black (Falcon)



Source: Bloomberg

52wks High-Low S\$0.440/S\$0.225

Number of Shares 823.4m

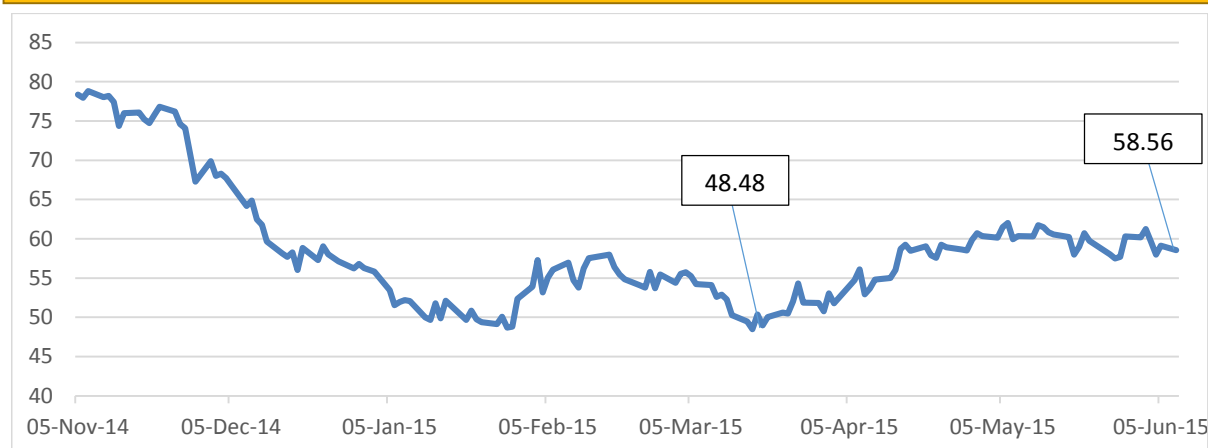
Market Capitalization S\$226.4m

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**Figure 1: Crude Oil WTI Spot Price (US\$ per barrel)**


Source: Bloomberg

**Various Funding Options Remain Open:** As of 31 March 2015, Falcon's net debt was about US\$245.2m and net debt to equity ratio was only about 79.1%. In our view, Falcon's financial health remains resilient through this challenging period for the oil and gas industry. Furthermore, through our own channel checks, we also found that financial institutions are generally open to consider extending credit facilities to Falcon, if there is a need that arise.

**Possible Corporate Strategies:** As of 31 March 2015, CHO has no debt and zero gearing. Management guided that there is consideration to gear up CHO while reducing Falcon's gearing to about 70%. By doing so, Falcon will free up more financial headroom to capture expansion opportunities when the industry turns around. We also suspect, given its 86.7% majority stake, Falcon may choose to privatize CHO and subsequently relisting it upon fully incorporating the new subsidiary.

**CHO's AHTS to boost Marine Division's Gross Margin:** CHO mainly operates AHTS on bareboat charters and the historical average gross margin is 79.0%. On the other hand, Falcon's Marine Division has a historical gross margin (FY13 to FY15) of 24.2%. Augmenting CHO will therefore, prop up Falcon's Marine Division gross margin notably.

**Figure 1: CH Offshore Historical Revenue and Gross Profit**

CH Offshore	FY10	FY11	FY12	FY13	FY14	9M FY15	Average
Revenue	63.117	58.554	51.514	47.819	35.137	25.656	
Gross Profit	47.963	42.696	36.859	40.001	30.637	21.596	
<b>Gross Margin</b>	<b>76%</b>	<b>73%</b>	<b>72%</b>	<b>84%</b>	<b>87%</b>	<b>84%</b>	<b>79%</b>

Source: Company, Voyage Research

**EPCC Project Updates and Oil Rigs Schedule:** As of 31 March 2015, Falcon's oilfield services order book still has an ongoing US\$200m EPCC project, expecting completion by FY2017. Meanwhile, Falcon also expects to deliver and sell 1 oil rig (market price: US\$200m to US\$250m) by 4Q FY2016. From FY2017 to FY2018, Falcon still has 4 more oil rigs on order, to be delivered about every quarterly.

**Forecast and Valuation:** We revised our model to incorporate Falcon's new structure upon consolidation of CHO, as well as factor in Falcon's performance in FY2015. We also rolled forward our estimates from FY2016 to FY2018. For FY2016, we expect Falcon to report revenue of US\$375m and net profit attributable to shareholders of US\$24.5m. For the rest of the forecast horizon in FY2017 and FY2018, we assume the industry turns around and that Falcon achieve an average revenue growth of 15% per annum, on gross margin of 25% (Falcon's historical gross margin for past 5 financial years is 25.7%). Based on our assumptions, we derived an intrinsic value of S\$0.555 per share. As such, we maintain our rating for Falcon Energy Group Limited at **Increase Exposure**.

**Figure 2: Economic Profit Valuation**

US\$m	FY16F	FY17F	FY18F
Revenue	375.0	412.5	453.8
EBIT	43.0	68.2	75.8
Tax on EBIT	-3.3	-5.8	-6.5
NOPLAT (Company)	39.7	62.4	69.3
Invested Capital	690.2	710.9	741.5
% of debt	55.1%	53.9%	51.0%
% of equity	44.9%	46.1%	49.0%
WACC	6.8%	6.8%	7.0%
Capital Charge	-46.6	-48.5	-51.8
Economic Profit	-6.9	13.9	17.5
Terminal			357.3
Discount Factor	0.94	0.88	0.82
Present Value	-6.5	12.2	14.3
Book Value	310.1		
Explicit Value	20.0	Risk Free	2.50%
Terminal Value	291.8	Beta	1
Value of Firm (US\$)	621.9	Market RP	7.50%
Value of Firm (S\$)	457.3	Cost of Equity	10.0%
Number of Shares	823.4	Cost of Debt	5%
Value per share (S\$)	<b>0.555</b>	LT Growth	2.0%
		SGDUSD Rate	1.36

Source: Voyage Research Estimates

**Figure 3: Results Overview**

Revenue US\$m	1Q FY14	2Q FY14	3Q FY14	4Q FY14	1Q FY15	2Q FY15	3Q FY15	4Q FY15	FY14	FY15
Marine	17.0	17.8	18.6	17.1	19.1	23.4	15.6	12.1	70.5	70.2
Oilfield Services	7.2	164.3	24.1	75.9	71.6	28.0	113.8	50.8	271.5	264.2
Oilfield Projects	2.0	2.0	2.0	2.7	2.0	2.0	2.0	2.0	8.7	8.0
Group	26.2	183.5	44.8	96.3	92.7	53.4	131.4	64.9	350.8	342.4
Gross Margin%	1Q FY14	2Q FY14	3Q FY14	4Q FY14	1Q FY15	2Q FY15	3Q FY15	4Q FY15	FY14	FY15
Marine	41.4%	30.9%	31.4%	24.9%	17.5%	11.7%	47.9%	-42.1%	32.1%	12.0%
Oilfield Services	22.5%	11.3%	22.4%	12.0%	12.2%	19.0%	8.3%	20.3%	33.9%	12.8%
Oilfield Projects	31.8%	28.8%	34.8%	11.9%	31.8%	31.8%	31.8%	36.6%	25.6%	33.0%
Group	35.5%	44.5%	26.8%	14.6%	13.8%	16.2%	13.3%	9.9%	33.4%	15.0%
<b>Group Gross Profit</b>	<b>9.3</b>	<b>81.6</b>	<b>12</b>	<b>14.1</b>	<b>12.8</b>	<b>8.7</b>	<b>17.5</b>	<b>12.4</b>	<b>117</b>	<b>51.4</b>
Other Op. Inc	0.9	1.1	0.3	8.8	1	18	0.8	3.3	11.1	23.1
Op. Exp	-4.8	-3.6	-5.5	-7.9	-5.1	-7.6	-6.1	-24.9	-21.8	-43.7
Associates & JV	3.8	0.9	1.3	1.2	2.6	2	1.5	1.6	7.2	7.7
<b>EBIT</b>	<b>9.1</b>	<b>80</b>	<b>8.2</b>	<b>16.1</b>	<b>11.2</b>	<b>21.1</b>	<b>13.6</b>	<b>-7.6</b>	<b>113.4</b>	<b>38.3</b>
<b>PATMI</b>	<b>8.3</b>	<b>38.9</b>	<b>6.1</b>	<b>7.6</b>	<b>8.1</b>	<b>19.7</b>	<b>6.5</b>	<b>-11.6</b>	<b>60.9</b>	<b>22.7</b>

Source: Voyage Research

**Figure 4: Financial Forecast and Estimates**

US\$m	FY11	FY12	FY13	FY14	FY15	FY16F	FY17F	FY18F
Revenue	79.9	94.6	116.2	350.8	342.4	375.0	412.5	453.8
Gross Profit	17.9	27.9	33.0	117.0	51.4	75.0	103.1	113.4
Operating Profit	11.0	16.6	4.7	113.5	38.3	43.0	68.2	75.8
Net Income After Taxes	5.6	10.6	-2.4	102.1	27.8	29.6	52.0	58.6
PATMI	3.3	10.4	-3.0	60.8	22.7	24.5	46.9	53.5
Total Current Assets	76.6	95.3	92.9	217.0	327.7	325.4	285.6	286.6
Total Non-Current Assets	291.8	309.1	295.3	358.2	518.0	541.5	613.6	685.7
Total Current Liabilities	67.9	71.4	74.7	179.4	288.4	282.3	259.1	265.0
Total Non-Current Liabilities	103.0	124.7	118.1	136.6	247.2	257.2	277.2	302.2
Total Equity	197.4	208.3	195.3	259.2	310.1	327.4	363.0	405.1
Net Income before tax	7.1	11.0	-1.7	108.2	30.9	32.9	57.8	65.1
Cash from Operating Activities	-15.7	1.7	16.1	149.5	94.5	50.2	81.3	80.4
Cash from Investing Activities	-14.5	-25.6	-31.0	-89.0	-145.4	-49.7	-99.7	-99.7
Cash from Financing Activities	29.9	24.9	14.5	-32.8	141.3	-8.9	-21.5	8.5
Net Change in Cash	-0.3	0.9	-0.4	27.7	90.4	-8.4	-39.9	-10.8
Inventory Days	141	229	4	2	1	5	5	5
Receivable Days	152	108	77	117	113	110	100	100
Trade Payables Days	45	37	35	142	72	70	70	70
ROE	1.8%	5.2%	-1.6%	25.1%	9.0%	9.1%	15.3%	15.4%
ROA	1.5%	2.6%	-0.6%	17.8%	3.3%	3.4%	5.8%	6.0%
Gross Debt/Gross Equity	66.8%	74.4%	75.5%	68.7%	110.9	106.1	94.4%	90.7%
Current Ratio	1.1	1.3	1.2	1.2	1.1	1.2	1.1	1.1
EPS (US cents)	-0.3	0.7	-0.4	7.5	2.8	3.0	5.7	6.5
BV/Share (US cents)	23.2	24.5	22.9	29.6	31.3	39.8	44.1	49.2
P/E	NA	30.8	NA	2.7	7.2	6.7	3.5	3.1
P/B	0.86	0.82	0.87	0.68	0.64	0.50	0.45	0.41

Source: Voyage Research

**Rating Definition:**

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

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.

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**IMPORTANT DISCLOSURE:**

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