

## Falcon Energy Group

### Towards a Diversified Business Model

Falcon Energy Group (Falcon) announced their 3Q 2010 results on 13 November 2010. The company experienced a tough quarter, with 1H 2010 revenue and profit falling 31.5% and 50.3% YoY respectively – largely due to the Marine segment. The company is looking for a more stable revenue stream through its recently established Resource division. We maintain our **Increase Exposure** call with a revised intrinsic value of S\$0.710 per share, having factored in the adjusted FY10 numbers, dilution of warrant issuance and weakening US\$.

#### Key Developments:

- Marine Division – Challenging Industry:** The division's revenue dived 58% YoY (63% QoQ) to US\$4.4m as a result of longer vessel turnaround time and soft marine market. The former led to lower utilization rates whilst the latter impacted the chartering rates. Consequently, gross profit margin declined from 58.6% in 3Q 2009 to 0.7% in 3Q 2010 – we concluded that fixed cost for the division is around US\$4.4m. The lackluster market is likely to flow into 4Q 2010. Management commented that they are seeking opportunities elsewhere, like in Indonesia and Malaysia, so as to improve their utilization rates.
- Oilfield Services Division – Positive Outlook:** This segment's revenue climbed 54% QoQ to US\$6.77m as more jobs are secured. Gross profit margin also inched 3.7% QoQ to 23.1% thanks to the higher top line. Services for this segment are likely to increase with the establishment of the Resource division.
- Oilfield Projects Division – Boosted by New Contracts:** The project segment reported a robust 3Q 2010, with revenue rising 378% YoY (86% QoQ) to US\$4.64m. This is largely attributable to more projects secured this quarter. As a result, gross profit spiked from US\$0.26m in 3Q 2009 (US\$0.92m in 2Q 2010) to US\$3.14m this quarter. The division is undergoing negotiations for new projects – contributions may be significant going forward.

## Increase Exposure

- Intrinsic Value S\$0.710
- Prev Closing S\$0.485

#### 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. A new Resource segment was established recently.

#### Financial Highlights

(Y/E Dec) US\$'mn	FY09	FY10F	FY11F
Revenue	89.2	68.7	89.3
Gross Profit	38.9	29.2	42.9
Net Profit	29.4	23.2	33.5
EPS (US cts)	3.75	2.70	3.13*

\*: Include Warrants

Source: SIAS Research Estimate

#### Key ratios (FY10F)

PER	13.3
P/BV	1.5
ROE	12.4%
Debt/Equity	50%
Current ratio	1.91

Source: SIAS Research Estimate

#### Indexed Price Chart

Green (FSSTI)

White (Falcon)



Source: Bloomberg

52wks High-Low 88.5 cents/46.0 cents  
 Number of Shares 814.1 m  
 Market Capitalization S\$394.8 m

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**Figure 1: Falcon's Segment Breakdown**

Revenue (US\$)	1Q 2010	2Q 2010	3Q 2010
Marine	13.16	11.96	4.40
Oilfield Services	3	4.39	6.77
Oilfield Projects	1.98	2.5	4.64
Gross Profit (US\$)			
Marine	8.40	7.09	0.03
Oilfield Services	1.05	0.85	1.58
Oilfield Projects	0.54	0.92	3.14

Due to weak marine market
Improving Performances

Source: SIAS Research

**Striving for a Diversified Business Model (Resource Division):** Falcon is currently highly dependent on the Marine division, which is cyclical in nature. In a bid for a more stable revenue stream and to tie through the lull marine period, the company has announced their intention to enter the energy sector via its recent acquisition of two Hong Kong registered companies, Capital Guardian Limited and Radford Holdings Limited. Management is confident about the prospects of this upcoming division as they are able to leverage on their existing business network. As the nature of this division is trading, we expect it to have high revenue but low profit margin.

**Company Outlook:** Falcon will continue to grow its three existing divisions. Marine division will attain an investment capital of up to US\$200m for new vessels while Oilfield Services division will benefit from the establishment of the Resource division – demand for logistic and warehouses are likely to increase. Oilfield Projects division is expected to be a key revenue driver going forward as the company is in negotiation for several projects ranging from US\$20m to US\$200m.

**Valuation – Dilution of Warrants:** In view of the poor 3Q 2010 results, we are revising our FY2010F revenue and profit to US\$68.7m and US\$23.2m respectively. On 24 September 2010, Falcon proposed a 1 in 5 warrants issue. Approximately 163m new warrants were placed out earlier this month, each with an issue price of S\$0.10 and an exercise price of S\$0.40 per share. We have factored in the revised 2010F numbers, warrants issuance and weakening US\$ into our model – which denoted a revised intrinsic value of S\$0.710 per share. Maintain **Increase Exposure**.

**Figure 2: Economic Profit Model**

US\$ '000	2010F	2011F	2012F	2013F
EBIT	27668	38592	44282	49893
Tax on EBIT	-830	-1544	-2214	-3493
Deferred Tax Liability	-72	-134	-189	-299
Minority Interest	-1158	-1609	-1799	-1985
NOPLAT	25608	35305	40080	44117
Total Invested Capital	164949	283209	337998	372036
WACC	8.2%	8.2%	7.8%	8.0%
Capital Charge	13583	23084	26532	29809
Economic Profit	12025	12221	13548	14308
Terminal				294018
Discount Rate	0.99	0.92	0.85	0.79
Present Value	11946	11226	11539	11282
Book Value	173875			
Explicit Value	45993		Risk Free	2.5%
Terminal Value	231840		MRP	7.5%
Value of Firm	451708		Cost of Equity	10.00%
Number of Shares	976920		Cost of Debt	5.0%
Input from Warrant	81410		Terminal G	3.0%
Value per Share (US\$)	0.546		WACC	9.2%
US Dollar Conversion	1.30			
Value in S\$	0.710			

Source: SIAS Research Estimates

**Figure 3: Financial Forecasts and Estimates**

US\$ '000	2008-15 mths	2009	2010F	2011F	2012F	2013F
Revenue	73838	89205	68688	89294	105367	121172
Gross Profit	41555	38884	29192	42861	50576	58163
Net Income Before Taxes	36759	30300	23883	33530	37870	42693
Net Income After Taxes	36109	29440	23166	32189	35976	39705
Total Current Assets	31392	87654	70724	59833	88995	90553
Total Non-Current Assets	127157	132446	254733	269542	294516	316524
Total Current Liabilities	30592	28214	36988	53715	57849	61957
Total Non-Current Liabilities	21172	12229	75516	85509	120502	120495
Total Equity	106785	173875	200064	215692	234972	257699
Net Income Before Tax	36759	30300	23883	33530	37870	42693
Cash from Operating Activities	52301	21160	20659	43104	47025	52288
Cash from Investing Activities	-52707	-31633	-112850	-57556	-35098	-31860
Cash from Financing Activities	7240	48150	73185	4366	13016	-22772
Net Change in Cash	6834	37677	-19006	-10086	24942	-2343
Net Cash - Beginning Balance	2518	9363	47054	28023	17907	42816
Net Cash - Ending Balance	9363	47054	28023	17907	42816	40438
Inventory Days	12	4	6	6	5	6
Receivable Days	117	119	209	163	144	137
Payable Days	238	129	108	91	96	106
ROE	32.2%	21.0%	12.4%	15.5%	16.0%	16.1%
ROA	22.7%	15.6%	8.6%	9.4%	9.1%	9.1%
Debt/Equity	26.5%	15.1%	50.0%	58.0%	68.1%	62.1%
Current Ratio	1.03	3.11	1.91	1.11	1.54	1.46
P/E	7.0	9.6	13.3	11.5	10.3	9.3
P/B	2.4	1.5	1.5	1.6	1.5	1.4

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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