

Falcon Energy Group

A Bitter Pill in the Short Term

Falcon Energy Group (Falcon) announced a disappointing set of FY10 results, with revenue and profit forming 94.1% and 50.4% of our forecasts. The depressed results were largely due to 1) the challenging marine market, 2) US\$3.4m provision for doubtful debt and 3) US\$3.8m exchange loss and interest expense. Falcon's outlook is likely to remain tough for 1H FY11 but we expect the company to record US\$12m profit for 2H FY11 owing to the recovering marine industry and the newly created resource division. Recommend **Invest** with an adjusted intrinsic value of S\$0.515.

Key Developments:

- Marine Division – Unanticipated Damper:** FY10 revenue dropped 26.5% YoY to US\$31.6m owing to lower utilization rates and softer charter rates. The completion of new vessels ordered during the 2007/2008 up-cycle had led to excess capacity in the industry and resulted in depressed rates consequentially. Segment profit also fell 58.5% YoY to S\$10.5m because of the competitive prices and fixed vessel maintenance expenses.
- Oilfield Services Division – Unwavering Performance:** Performance for this division was stable, with 4Q FY10 revenue and profit declining 2.4% and rising 17.6% QoQ respectively. We expect contribution from this division to soar following the commissioning of the newly established resource division, which is likely to occur after 2Q FY11.
- Oilfield Projects Division - :** Due to the completion of one of the projects, 4Q FY10 revenue and profit dipped 32.8% and 48.5% YoY respectively to S\$3.12m and S\$1.62m. We also noted that there was a US\$2.8m provision of doubtful debts from this division. Management commented that this impairment was done on conservative stand and it is probable that the amount due will be collected.

Invest

- Intrinsic Value S\$0.515
- Prev Closing S\$0.360

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	FY10	FY11F
Revenue	89.2	64.6	72.4
Gross Profit	38.9	24.6	28.9
Net Profit	29.4	11.7	14.5
EPS (US cts)	3.75	1.39	1.45*

*: Include Warrants

Source: SIAS Research Estimate

Key ratios (FY11F)

PER*	19.5
P/BV*	1.1
ROE	7.6%
Debt/Equity	54.4%
Current ratio	1.43

*: Include Warrants

Source: SIAS Research Estimate

Indexed Price Chart

Green (FSSTI)

White (Falcon)



Source: Bloomberg

52wks High-Low	76.5 cents/35.0 cents
Number of Shares	814.1 m
Market Capitalization	S\$297.2 m

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Figure 1: Falcon's Segment Breakdown

Revenue (US\$m)	1Q 2010	2Q 2010	3Q 2010	4Q 2010	FY 2010
Marine	13.16	11.96	4.40	2.08	31.60
Oilfield Services	3.00	4.39	6.77	6.61	20.77
Oilfield Projects	1.98	2.50	4.64	3.12	12.24
Gross Profit (US\$m)					
Marine	8.40	7.09	0.03	-2.44	13.08
Oilfield Services	1.05	0.85	1.58	1.86	5.34
Oilfield Projects	0.54	0.92	3.14	1.62	6.22

Due to weak marine market

Stable Performances

Source: SIAS Research

Understanding the current offshore support vessel (OSV) market: Challenging is the appropriate word for the present OSV market owing to 1) completion of many newly built fleets from the 2007/2008 bull market, 2) weak demand pickup as oil operators were previously cautious over CAPEX spending and 3) speculative builds by shipyard operators to keep their yard ongoing.

Oil exploration and production activities inched up slightly in FY10 but were insufficient to compensate for the influx of new vessels. Subsequently, many operators cut their rates, sometimes significantly, so as to keep their vessels operating. This affected Falcon considerably as they lost bids for several chartering projects by a marginal amount.

Outlook for FY11: For the marine segment, 1H FY11 is likely to remain tough as many oil operators just initiated projects for new sites and thus, demand for OSV will probably kick in after 2H FY11. In addition, there are finance costs of approximately US\$700k per quarter, largely due to the acquisition of CH Offshore. We do not expect much deviation from the oilfield services division for 1H FY11 and expect this division to outshine in 2H FY11 on the back of the new resource division. The group's gearing may rise by approximately US\$10m to develop the resource division. Pertaining to the oilfield projects division, management indicated that they are still in negotiation for sizeable projects.

Valuation – A bitter pill in the short term: Falcon's near term outlook is unlikely to be fantastic – we expect 1Q FY11 to be around breakeven level and 2Q FY11 profit to be around US\$2.5m. Income is likely to come in after 2H FY11, pending on 1) the marine industry and 2) the newly created resource division. We estimate US\$12m profit for 2H FY11 and will adjust accordingly as we obtain a clearer picture of the industry. As our intrinsic value is still higher than the warrant's conversion price of S\$0.40 per share, we will assume full warrant conversion. Recommend **Invest** with an adjusted intrinsic value of S\$0.515.

Figure 2: Economic Profit Model

US\$ '000	2010	2011F	2012F	2013F
EBIT	16197	20214	30681	38614
Tax on EBIT	-623	-910	-1534	-2703
Deferred Tax Liability	563	-678	-129	-234
Minority Interest	-381	-390	-1225	-1558
NOPLAT	15756	18236	27793	34119
Total Invested Capital	164949	282459	286794	313167
WACC	8.3%	8.2%	8.2%	8.3%
Capital Charge	13730	23075	23528	25953
Economic Profit	2026	-4839	4265	8167
Terminal				159097
Discount Rate		0.99	0.91	0.84
Present Value		-4776	3890	6879
Book Value	189070			
Explicit Value	5993		Risk Free	2.5%
Terminal Value	134016		MRP	7.5%
Value of Firm	329080		Cost of Equity	10.00%
Number of Shares	976920		Cost of Debt	5.0%
Input from Warrant	65120		Terminal G	3.0%
Value per Share (US\$)	0.404		WACC	9.2%
US Dollar Conversion	1.276			
Value in S\$	0.515			

Source: SIAS Research Estimates

Figure 3: Financial Forecasts and Estimates

US\$ '000	2007	2008-15 mths	2009	2010	2011F	2012F	2013F
Revenue	38582	73838	89205	64610	72363	83218	91539
Gross Profit	20844	41555	38884	24615	28945	37448	43939
Net Income Before Taxes	18455	36759	30300	12151	15222	25787	33496
Net Income After Taxes	17372	36109	29440	11684	14537	24498	31151
Total Current Assets	23045	31392	87654	49872	50092	46055	46767
Total Non-Current Assets	72633	127157	132446	248460	265133	288616	308310
Total Current Liabilities	14089	30592	28214	33337	35052	44659	48576
Total Non-Current Liabilities	9065	21172	12229	69719	80449	80442	80435
Total Equity	72524	106785	173875	195276	199725	209569	226067
Net Income Before Tax	17625	36759	30300	12151	15222	25787	33496
Cash from Operating Activities	7502	52301	21160	15692	22489	25822	34018
Cash from Investing Activities	-34213	-52707	-31633	-117967	-9698	-20392	-17158
Cash from Financing Activities	26045	7240	48150	67378	-6964	-14568	-19793
Net Change in Cash	-666	6834	37677	-34897	5827	-9138	-2933
Net Cash - Beginning Balance	3182	2518	9363	47054	12303	18100	8929
Net Cash - Ending Balance	2518	9363	47054	12303	18100	8929	5961
Inventory Days		12	4	6	6	5	5
Receivable Days		117	119	204	157	135	140
Payable Days		238	129	91	67	77	87
ROE		32.2%	21.0%	6.4%	7.6%	12.4%	14.9%
ROA		22.7%	15.6%	4.5%	4.7%	7.5%	9.0%
Debt/Equity		26.5%	15.1%	50.1%	54.4%	55.8%	53.1%
Current Ratio		1.03	3.11	1.50	1.43	1.03	0.96
P/E*		5.5	7.5	20.3	19.5	11.8	9.3
P/B*		1.9	1.2	1.2	1.1	1.0	1.0

*: Include Warrants

Source: SIAS Research Estimates

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.

IMPORTANT DISCLOSURE:

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