

## Falcon Energy Group

### Seeing Recovery in the Marine Business

Falcon Energy Group's (Falcon) 1Q revenue soared 119% YoY to US\$35.9m while PAT declined 62% YoY to US\$1.4m. The former was boosted by the Oilfield Services division, which was engaged in a short term procurement contract. The latter was due to loss incurred by Federal Offshore Services Pte Ltd for the one-off provision of a doubtful debt (about US\$1.6m). Excluding the impact from associates, PBT would have rose US\$1.4m YoY.

The company is experiencing higher utilization rates in the Marine division and the Oilfield Services division may have a huge jump in revenue as the division engages in a procurement contract. Falcon has also secured two coal concessions for its Resource division and production may kick start in 2H FY12. We are lowering Falcon FY12F PAT to US\$18m in view of the Federal Offshore loss. Maintain **Increase Exposure**.

#### Key Developments:

**Marine Division – A Healthy Start:** The Marine division's 1Q revenue and gross profit stood at US\$8.6m and US\$2.1m respectively, largely in line with our expectations. There was a general improvement in utilization rate on the back of demand from the region. That said, we expect this division's performance to continue improving QoQ.

#### Oilfield Services Division – Potential Revenue Jump:

The division's revenue came in at a stunning US\$24.0m, mainly due to a short term procurement contract. However, the mentioned contract's margin is low as Falcon adopts a back to back procurement with no speculative position. This resulted in the division recognizing a lower gross profit margin of 8.5% (fell 16.5% points YoY). We reckon that there is a possibility where the procurement contract may be recurring and if so, the Oilfield Services division will contribute >60% of the group's revenue.

**Oilfield Projects Division – Steady Numbers:** Another set of stable numbers was posted by this division with +/- US\$0.1m revenue and gross profit variation YoY and QoQ. We expect this entity's performance to remain stable.

## Increase Exposure

- Intrinsic Value S\$0.500
- Prev Close S\$0.205

#### 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 Services and Oilfield Projects. A new Resource segment was established recently and the company entered into the oil rig business with a consortium.

#### Financial Highlights

(Y/E Dec) US\$'mn	FY10	FY11	FY12F
Revenue	64.6	79.9	87.9
Gross Profit	24.6	17.9	30.8
PATMI	11.3	3.3	16.0
EPS (US cts)	1.39	0.40	1.64*

\*: Include Warrants

Source: SIAS Research Estimates

#### Key ratios (FY12F)

PER*	9.8
P/BV*	0.6
ROE	9.1%
Debt/Equity	64.4%
Current ratio	1.20

\*: Include Warrants

Source: SIAS Research Estimates

#### Indexed Price Chart

Green (FSSTI)

White (Falcon)



Source: Bloomberg

52wks High-Low	36.0 cents/16.6 cents
Number of Shares	814.1 m
Market Capitalization	S\$166.9m

#### Analyst:

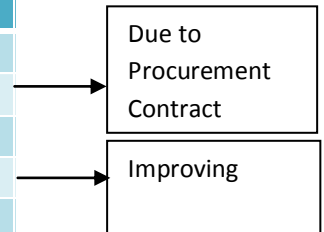
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**Figure 1: Falcon's Segment Breakdown**

Revenue (US\$m)	1Q 2011	2Q 2011	3Q 2011	4Q 2011	1Q 2012
Marine	2.88	1.80	6.69	11.61	8.58
Oilfield Services	10.19	7.58	15.30	10.50	23.98
Oilfield Projects	3.31	3.34	3.38	3.37	3.34
Gross Profit (US\$m)					
Marine	-1.32*	-2.19*	2.25	0.66	2.09
Oilfield Services	2.51*	2.27	2.59	3.56	2.04
Oilfield Projects	1.84	1.94*	1.88	1.87	1.95



\*: SIAS Research Estimates

Source: SIAS Research

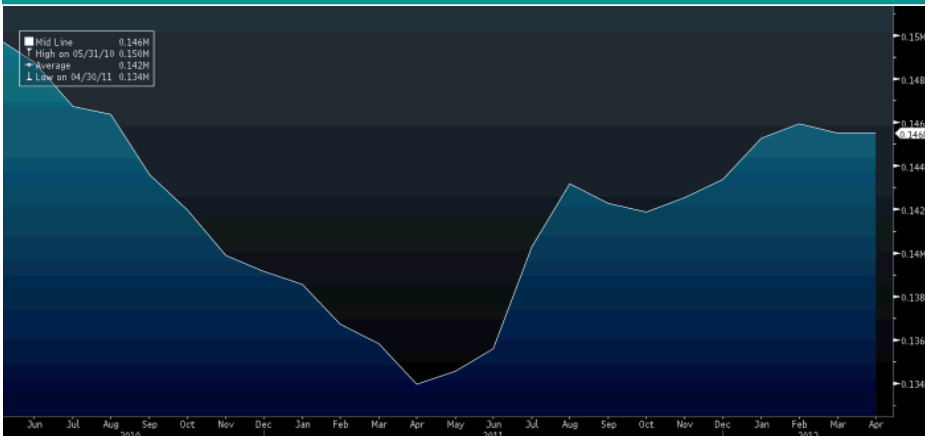
**Company Update:** The utilization rate of the marine fleet is improving gradually on the back of demand from regional areas such as Indonesia and Malaysia. Thus, we expect the subsequent quarters' performance to be better than 1Q FY12.

The est. US\$1.6m loss in Federal Offshore (a 40% owned vessel operator and charterer) was due to the failure of a yard to deliver a contracted vessel and the yard's inability to refund the deposit owing to cash flow issues. This provision is one-off and has no impact on Falcon's core businesses. That said, CH Offshore probably contributed US\$2.5m in 1Q FY12.

Falcon has secured two coal concessions in East Kalimantan and is in the process of negotiating with other concession holders. Production will probably kick start in 2H FY12 after the production permits are acquired. For the oil rig business, the company is looking at new opportunities (probably the two optional rigs).

**Valuation:** The loss in Federal Offshore was unanticipated and Falcon's PAT could have been US\$3m instead of US\$1.4m. Whilst the Marine division's outlook is recovering, we reckon that it will be slightly challenging for the company to achieve our previous FY12F PAT of US\$19.5m. Thus, we are lowering the figure to US\$18.0m. Maintain **Increase Exposure**.

**Figure 2: Contracted IC Rigs >350ft**



Source: Bloomberg

**Figure 3: Economic Profit Model**

US\$ '000	2010	2011	2012F	2013F
EBIT	16197	10982	25371	41049
Tax on EBIT	-623	-2369	-2537	-4105
Deferred Tax Liability	563	-1060	0	0
Minority Interest	-381	-2282	-2000	-2000
NOPLAT	15756	5271	20834	34944
Total Invested Capital	164949	282459	335967	356538
WACC	8.0%	7.7%	7.3%	7.6%
Capital Charge	13182	21871	24571	27063
Economic Profit			-3737	7881
Terminal				167073
Discount Rate			0.94	0.87
Present Value			-3513	6886
Book Value	189030			
Explicit Value	3373		Risk Free	2.5%
Terminal Value	145969		MRP	7.0%
Value of Firm	338372		Cost of Equity	9.50%
Number of Shares	976920		Cost of Debt	5.0%
Input from Warrant	52096		Terminal G	2.7%
Value per Share (US\$)	0.400		WACC	8.7%
US Dollar Conversion	1.25			
Value in S\$	0.500			

Source: SIAS Research Estimates

**Figure 4: Financial Forecasts and Estimates**

US\$ '000	2009	2010	2011	2012F	2013F
Revenue	89205	64610	79949	87944	92341
Gross Profit	38884	24615	17858	30780	44324
Net Income Before Taxes	30300	12151	7084	19971	35537
Net Income After Taxes	29440	11684	5556	17974	31983
Total Current Assets	87654	49872	76558	82518	92946
Total Non-Current Assets	132446	248460	291758	306644	326793
Total Current Liabilities	28214	33337	67909	68962	67556
Total Non-Current Liabilities	12229	69719	102969	103630	103630
Total Equity	173875	195276	197438	215412	247395
Net Income Before Tax	30300	12151	7084	19971	35537
Cash from Operating Activities	21160	15692	-16087	16489	33938
Cash from Investing Activities	-31633	-117967	-14134	-17086	-23149
Cash from Financing Activities	48150	67378	31080	828	-2000
Net Change in Cash	37677	-34897	859	231	8789
Net Cash - Beginning Balance	9363	47054	12303	13097	13328
Net Cash - Ending Balance	47054	12303	13097	13328	22117
Inventory Days	4	6	58	102	99
Receivable Days	119	204	164	165	168
Payable Days	129	91	93	159	194
ROE	21.0%	6.4%	2.9%	9.1%	14.5%
ROA	15.6%	4.5%	1.7%	4.7%	7.9%
Debt/Equity	15.1%	50.1%	69.4%	64.4%	55.3%
Current Ratio	3.11	1.50	1.13	1.20	1.38
P/E*	4.3	11.6	39.9	9.8	5.2
P/B*	0.7	0.7	0.5	0.6	0.5

\*: Include Warrants for FY12F and FY13F

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.

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