

Falcon Energy Group

The Tide is Changing

We met up with Falcon Energy Group's (Falcon) management late last week to discuss the company's outlook. The company expects 2H FY11F to be better owing to 1) deeper marketing presence from the marine division, 2) healthy growth from the oilfield services and oilfield projects divisions and 3) maiden contribution from the resource division.

Falcon's 1Q FY10 net profit of S\$3.7m was above our expectations as we had previously projected the company to be at breakeven level. Due to the positive outlook, we are revising our FY11F PATMI from US\$14.5m to US\$16.7m. Though the value per share rose from 40.4 US cents to 41.5 US cents, the weaker US\$ negated the positive impact. Maintain **Increase Exposure** with an intrinsic value of S\$0.515.

Key Developments:

- Marine Division – Slight Improvement:** The marine division's 1Q revenue rose 38.4% QoQ (declined 78.1% YoY) to S\$2.88m. Utilization rates continued to be low, at around 30%, owing to influx of new vessels and little addition in new activities. This segment was probably loss making (at gross profit level) for the quarter.
- Oilfield Services Division – Extraordinary Quarter:** This division continued its outstanding record with 1Q revenue and profit rising 240% and 143% YoY to US\$10.19m and US\$2.55m respectively. We expect the division's FY11F results to surpass that of FY10, with gross profit margin at around 25%.
- Oilfield Projects Division – Steady Numbers:** This project division posted a credible set of results with 1Q revenue and profit rising 67.2% and 224% YoY to US\$3.31m and US\$1.75m respectively. We are of the view that the company may be able to secure more projects. This division's gross profit margin is estimated to be around 53%.

Increase Exposure

- Intrinsic Value S\$0.515
- Prev Closing S\$0.335

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
PATMI	28.1	11.3	16.7
EPS (US cts)	3.75	1.39	1.71*

*: Include Warrants

Source: SIAS Research Estimates

Key ratios (FY11F)

PER*	15.8
P/BV*	1.0
ROE	8.9%
Debt/Equity	53.6%
Current ratio	1.43

*: Include Warrants

Source: SIAS Research Estimates

Indexed Price Chart

Green (FSSTI)

White (Falcon)



Source: Bloomberg

52wks High-Low	60.0 cents/33.5 cents
Number of Shares	814.1 m
Market Capitalization	S\$272.7 m

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Figure 1: Falcon's Segment Breakdown

Revenue (US\$m)	1Q 2010	2Q 2010	3Q 2010	4Q 2010	1Q 2011
Marine	13.16	11.96	4.40	2.08	2.88
Oilfield Services	3.00	4.39	6.77	6.61	10.19
Oilfield Projects	1.98	2.50	4.64	3.12	3.31
Gross Profit (US\$m)					
Marine	8.40	7.09	0.03	-2.44	-1.27*
Oilfield Services	1.05	0.85	1.58	1.86	2.55*
Oilfield Projects	0.54	0.92	3.14	1.62	1.75*

Slight Improvement
Stable Performances

*: SIAS Research Estimates

Source: SIAS Research

Company Development: Falcon had started broadening its marine division's marketing presence by setting up offshore branches – which allow the company to improve its overseas penetration rate. This enables the company to attain more-than-usual vessel enquiries which will subsequently improve their utilization and chartering rates.

On the industry level, there have also been insistent requests for OPEC to increase their production level, which may help to boost new oil production activities. We continue to expect this segment's performance to improve significantly in 2H FY11F and generate net profit for the full year.

Pertaining to the oilfield services and oilfield projects divisions, we expect these segments to grow progressively and contribute US\$13m gross profit for FY11F (vs FY10's US\$11.56m). We also project CHO to maintain its performance and conservatively estimate S\$8m net profit from the associates.

Falcon has been putting a considerable level of attention on the new resource division. The company intends to invest US\$70-80m in various stages for the purchase of concessions and production facilities. Falcon is likely to commence production in 3Q FY11 and secure long term contracts thereafter. We anticipate US\$2m net profit from this segment. Management envisages this division to gradually increase its production level to 5m tons of coal annually over the next few years.

Valuation – Maintain Value: Falcon's 1Q PATMI exceeded our previous projection of approximately breakeven level. In 2Q, we expect a slightly better performance from all segments and hence, are revising our projection from US\$2.5m to US\$4.5m. We are also increasing our 2H FY11F PATMI from US\$12m to US\$14m in view of the better industry outlook. As such, we are revising our FY11F PATMI from US\$14.5m to US\$16.7m. Though the value per share rose from 40.4 US cents to 41.5 US cents, the weaker US\$ negated the effect. Recommend **Increase Exposure** with an intrinsic value of S\$0.515.

Figure 2: Economic Profit Model

US\$ '000	2010	2011F	2012F	2013F
EBIT	16197	22933	33377	41280
Tax on EBIT	-623	-1032	-1669	-2890
Deferred Tax Liability	563	-690	-142	-253
Minority Interest	-381	-390	-1353	-1681
NOPLAT	15756	20821	30212	36456
Total Invested Capital	164949	282459	289513	318710
WACC	8.6%	8.4%	8.5%	8.6%
Capital Charge	14133	23785	24530	27324
Economic Profit	1623	-2964	5682	9132
Terminal				168762
Discount Rate		0.99	0.91	0.84
Present Value		-2925	5168	7650
Book Value	189070			
Explicit Value	9894		Risk Free	2.5%
Terminal Value	141377		MRP	7.5%
Value of Firm	340341		Beta	1.05
Number of Shares	976920		Cost of Equity	10.37%
Input from Warrant	65120		Cost of Debt	5.0%
Value per Share (US\$)	0.415		Terminal G	3.0%
US Dollar Conversion	1.24			
Value in S\$	0.515			

Source: SIAS Research Estimates

Figure 3: Financial Forecasts and Estimates

US\$ '000	2009	2010	2011F	2012F	2013F
Revenue	89205	64610	72363	83218	91539
Gross Profit	38884	24615	28945	37448	43939
Net Income Before Taxes	29440	11684	17134	27059	33630
PATMI	28093	11303	16744	25706	31948
Total Current Assets	87654	49872	49982	45951	46620
Total Non-Current Assets	132446	248460	267853	294031	316391
Total Current Liabilities	28214	33337	35064	44685	48620
Total Non-Current Liabilities	12229	69719	80449	80442	80435
Total Equity	173875	195276	202322	214727	233703
Net Income Before Tax	30300	12151	17941	28483	36161
Cash from Operating Activities	21160	15692	22378	25703	33852
Cash from Investing Activities	-31633	-117967	-9698	-20266	-17036
Cash from Financing Activities	48150	67378	-6964	-14568	-19793
Net Change in Cash	37677	-34897	5717	-9131	-2977
Net Cash - Beginning Balance	9363	47054	12303	17990	8826
Net Cash - Ending Balance	47054	12303	17990	8826	5814
Inventory Days	4	6	6	5	5
Receivable Days	119	204	157	135	140
Payable Days	129	91	67	77	87
ROE	21.0%	6.4%	8.9%	13.4%	15.6%
ROA	15.6%	4.5%	5.6%	8.2%	9.6%
Debt/Equity	15.1%	50.1%	53.6%	54.4%	51.3%
Current Ratio	3.11	1.50	1.43	1.03	0.96
P/E*	7.2	19.5	15.8	10.3	8.3
P/B*	1.2	1.2	1.0	1.0	0.9

*: 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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