

## Falcon Energy Group Limited

### Looking Forward to Completion of Acquisition

Falcon Energy Group Limited (Falcon) announced on 9 February 2015 that it is revising the offer price for CH Offshore Ltd (CHO) to S\$0.550, and that it has received irrevocable undertakings, including that from Chuan Hup Holdings Limited, to accept the offer, in relation to 222.2m CHO shares, representing 31.52% of CHO. As such, Falcon will have equivalent ownership of about 62% of CHO. The offer has been extended to 27 February 2015.

**Offer Values CHO at S\$387.8m:** The offer values CHO at 13.9 times trailing 12M earnings of US\$21.99m and at 1.28 times book value of equity as of 31 December 2014, based on average 2014 exchange rate of USD1:SGD1.266 and exchange rate of USD1:SGD1.323 as of 31 December 2014.

**While Falcon Looks Attractively Priced:** Stripping away its existing 205.3m of CHO shares (S\$112.9m @ S\$0.550 each), Falcon's adjusted market capitalization of S\$109.7m works out to about 2.1 times FY15F P/E. We expect the company to earn PATMI of US\$38.9m (or S\$52.5m @ USD1:SGD1.3542 as of 11 Feb) for FY15F. Including the valid acceptances received as of 9 February 2015 and the 31.52% of CHO subjected to the irrevocable undertaking, Falcon's holding of CHO will have an equivalent value of S\$240.5m, which is 8% more than Falcon's market capitalization as of 11 February 2015. Unadjusted, Falcon trades at about 4.24 times FY15 P/E.

**Has Room for Gearing to Rise:** As of 31 December 2014, Falcon's net debt amounted to US\$151.0m, or 56% of common equity. The successful acquisition of 100% of CHO will cost Falcon about S\$275.0m. If financed entirely through debt or cash on hand (as intended by the company), net gearing is likely to rise to 1.32 times, which can be funded by an existing S\$500m medium term note facility. Thereafter, the company can raise equity from 81.97m of outstanding bonus warrants, with a strike price of S\$0.430 each, as of 31 December 2014; and 11.44m of treasury shares which can also be issued to investors for funding. As such, we can see that Falcon still has various funding options at hand to manage its capital position. 9M FY15 net operating cash flow was also positive, at US\$10.4m.

## 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 the post production stage. The business is divided into three segments: Marine, Oilfield Services and Oilfield Projects. The Resource divisions and Drilling Services division were established more recently.

### Financial Highlights

(Y/E Mar) US\$m	FP13	FY14	FY15F
Revenue	116.2	350.8	357.5
Gross Profit	33.0	117.0	51.8
PATMI	-3.0	60.8	38.8
EPS (US cts)	-0.37	7.45	4.79

Source: Voyage Research Estimates

### Key ratios (FY15F)

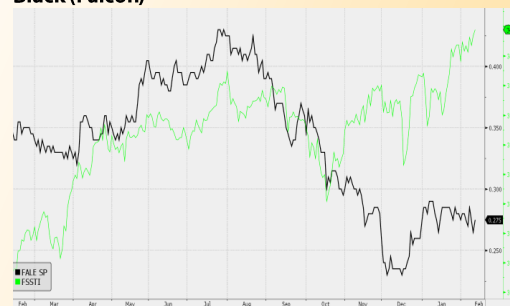
PER	4.24
P/BV	0.59
Ret. on Com. Equity	14.9%
Gross Debt/Equity	86.0%
Current ratio	1.54

Source: Voyage Research Estimates

### Indexed Price Chart

Green (FSSTI)

Black (Falcon)



Source: Bloomberg

52wks High-Low	44.0 cents/ 22.5 cents
Number of Shares	809.50m
Market Capitalization	S\$222.6m

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**Results Overview:** Other than the revision of its offer for CHO, Falcon had earlier announced its 3Q FY15 (ended 31 December 2014) on 6 February 2015. During 3Q FY15, revenue climbed by 193.4% year-on-year and 146% when compared to 2Q. The increase was mainly due to contribution from engineering, procurement, construction & commissioning (EPCC) projects at the oilfield services segment. These projects will stretch into 2016.

Group gross margin declined to 13.3%, due to higher revenue contribution from the oilfield services segment, which has lower gross margin. However, gross profit climbed to US\$17.5m compared to US\$12.0m a year ago due to the higher revenue base. Operating expenses remained stable at about US\$6.1m. Including contribution of US\$2.2m from other operating income and JVs & associates, Falcon ended 3Q FY15 with PATMI of US\$6.5m (+7.4% year-on-year).

**Figure 1: Results Overview**

Revenue, US\$m	1Q FY14	2Q FY14	3Q FY14	4Q FY14	1Q FY15	2Q FY15	3Q FY15
Marine	17.0	17.8	18.6	17.1	19.1	23.4	15.6
Oilfield Services	7.2	35.8	24.1	75.9	71.6	28.0	113.8
Oilfield Projects	2.0	2.0	2.0	2.7	2.0	2.0	2.0
<b>Group</b>	<b>26.2</b>	<b>183.5</b>	<b>44.8</b>	<b>96.3</b>	<b>92.7</b>	<b>53.4</b>	<b>131.4</b>
Gross Margin (%)	1Q FY14	2Q FY14	3Q FY14	4Q FY14	1Q FY15	2Q FY15	3Q FY15
Marine	41.4%	30.9%	31.4%	24.9%	17.5%	11.7%	47.9%
Oilfield Services	22.5%	11.3%	22.4%	12.0%	12.2%	19.0%	8.3%
Oilfield Projects	31.8%	28.8%	34.8%	11.9%	31.8%	31.8%	31.8%
<b>Group</b>	<b>35.5%</b>	<b>44.5%</b>	<b>26.8%</b>	<b>14.6%</b>	<b>13.8%</b>	<b>16.2%</b>	<b>13.3%</b>
<b>Group Gross Profit</b>	<b>9.3</b>	<b>81.6</b>	<b>12.0</b>	<b>14.1</b>	<b>12.8</b>	<b>8.7</b>	<b>17.5</b>
Other Op. Inc.	0.9	1.1	0.3	8.8	1.0	18.0	0.8
Op. Exp.	-4.8	-3.6	-5.5	-7.9	-5.1	-7.6	-6.1
Associates & JV	3.8	0.9	1.3	1.2	2.6	2.0	1.5
<b>EBIT</b>	<b>9.1</b>	<b>80.0</b>	<b>8.2</b>	<b>16.1</b>	<b>11.2</b>	<b>21.1</b>	<b>13.6</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>

The company earned revenue of US\$128.4m with gross margin of 56.1% from the drilling division in FY14. No revenue from the drilling division was earned in 9M FY15.

Source: Company, Voyage Research

**Forecasts and Valuation:** We revised our forecasts for FY15 to factor in the company's results for 3Q FY15. For FY15, we estimate the company to report revenue of US\$394.2m and net profit attributable to shareholders of US\$24.1m. These estimates in turn imply 4Q FY15F revenue of US\$80m and PATMI of US\$4.5m. As revenue from oilfield services spiked up to US\$113.8m in 3Q FY15, we conservatively estimate revenue from oilfield services and oilfield projects to be in the range of US\$50m to US\$60m, to factor in possible timing difference in billings.

On the other hand, we expect revenue from the marine division to be close to US\$20m, in line with prior quarters' trend (average of US\$18.4m from 1Q FY14 to 3Q FY15). Gross margin for the marine division is projected to be in the range of 25%, whilst that of oilfield services and projects is estimated to be around 10%.

However, we do not revise our valuation nor provide longer term forecasts. The company's cost structure and revenue streams are likely to substantially change once CHO is acquired. As the company's ultimate shareholding of CHO is still uncertain at this stage, we decide to revise our valuation at a later stage; when the acquisition of CHO is completed. As we see the acquisition of CHO as a positive for Falcon, we remain optimistic over its outlook.

**Figure 2: Financial Forecasts and Estimates**

	FY2010	FY2011	FP2013	FY2014	FY2015F
Revenue	64.6	79.9	116.2	350.8	357.5
Gross Profit	24.6	17.9	33.0	117.0	51.8
EBIT	16.2	11.0	4.7	113.5	54.6
PATMI	11.3	3.3	-3.0	60.8	38.8
Total Current Assets	49.9	76.5	92.9	217.0	290.7
Total Non-Current Assets	248.5	291.9	295.3	358.2	393.4
Total Current Liabilities	33.3	67.9	74.7	179.4	189.2
Total Non-Current Liabilities	69.7	103.0	118.1	136.6	189.2
Total Equity	195.3	197.4	195.3	259.2	305.6
Net Cash from Operating Activities	15.7	-16.1	16.1	149.5	52.1
Net Cash from Investing Activities	-118.0	-14.1	-31.0	-89.0	-49.0
Net Cash from Financing Activities	67.4	31.1	14.5	-32.8	60.4
Net Change in Cash	-34.9	0.9	-0.4	27.7	63.5
Inventory Turnover Days	10	5	4	2	2
Receivable Turnover Days	140	127	91	71	120
Payable Turnover Days	52	34	34	77	90
Ret. On Com. Equity	6.2%	1.7%	-1.6%	28.4%	14.9%
Return on Assets	4.5%	1.7%	-0.6%	21.2%	7.6%
Gross Debt / Com. Equity	50.4%	69.7%	79.2%	73.7%	86.0%
Current Ratio	1.50	1.13	1.24	1.21	1.54
EPS (US cents)	1.39	0.4	-0.37	7.45	4.79
BV (US cents)	23.22	23.22	22.87	29.57	34.48
P/E	14.61	50.77	-54.88	2.73	4.24
P/BV	0.87	0.87	0.89	0.69	0.59

Source: Company, 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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