

Falcon Energy Group

Expanding Fleet through Acquisition

Falcon Energy Group Limited (Falcon) announced on 11 December 2014 that its wholly-owned subsidiary Energian Pte Ltd is making a voluntary conditional cash offer for all paid-up ordinary shares of CH Offshore Ltd (CHO) at S\$0.495 per CHO share. The offer price translates to 10.6x CHO's FY14 EPS of 3.56 US cents and 1.085x CHO's 1Q FY15 book value of 34.82 US cents. The FTSE ST Oil and Gas Index currently trades at 8.8x P/E versus a six year median of 11.7x. Therefore, the offer will likely allow Falcon to expand its fleet at an attractive price, while offering relative premium to existing CHO shareholders.

Expanding Fleet Capabilities: Falcon currently owns and manages a fleet of 22 vessels, of which 13 are accommodation work barges. Only one ship is an anchor handling tug supply (AHTS) vessel. On the other hand, CHO operates a fleet of 15 AHTS vessels, of which nine of them are wholly-owned. Therefore, the acquisition of CHO, if successful, will allow Falcon to both expand its fleet and strengthen its range of products and services. Via the acquisition, Falcon will also be able to potentially reach out to a broader pool of customers as CHO has a lengthy track record in the global oil and gas industry, having customers in Southeast Asia, the Middle East, the Americas, Africa and Russia.

Summary of Transaction: The offer price represents a premium of 6.45% over CHO's last traded price of S\$0.465 prior to the announcement of the transaction. Currently, Falcon already owns 29.07% of CHO and will have to pay up to S\$247.5m, to be funded via bank borrowings and internal resources, for the remaining 500.09m CHO shares.

Substantial shareholder and SGX listed company Chuan Hup Holdings Limited (CHH), which owns 23.76% of CHO, has announced that, in the "best interest" of its shareholders, it is considering its "options...", including but not limited to whether or not to accept the offer". The board of CHO will be appointing an independent financial advisor, whose advice and recommendation will be included in a circular to be sent to CHO shareholders.

Increase Exposure

- Intrinsic Value S\$0.555
- Prev Close S\$0.235

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 recently.

Financial Highlights

(Y/E Mar) US\$m	FP13	FY14	FY15F
Revenue	116.2	350.8	272.1
Gross Profit	33.0	117.0	81.6
PAT	-2.4	102.1	46.1
EPS (US cts)	-0.37	7.45	5.67

*FP13: 1 Jan 2012 to 31 Mar 2013

Source: Voyage Research Estimates

Key ratios (FY15F)

PER	3.16
P/BV	0.52
ROE	17.7%
Debt/Equity	69.9%
Current ratio	1.65

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	812.4m
Market Capitalization	S\$190.9m

Analyst:

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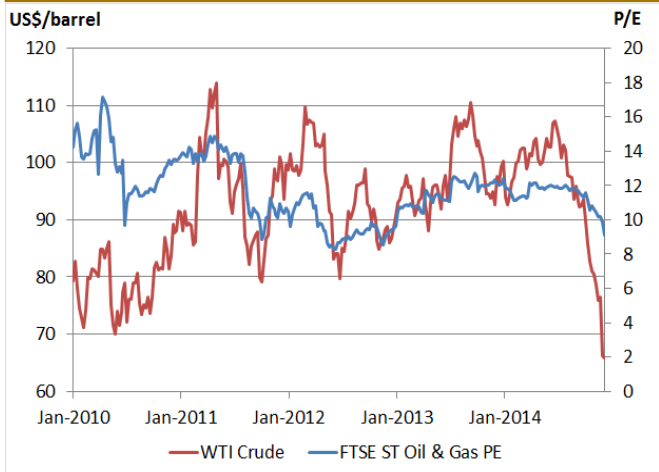
Tel: 6227 2107

Forecasts and Valuation: Since our last update on Falcon dated 13 August 2014, we have revised our forecasts and valuation to factor in the company’s 1H FY15 results. The company’s financial year ends in March each year. We currently expect the company to make net profit after tax of US\$46.1m and revenue of US\$272.1m for FY15F, translating to 1.86x and 1.54x the company’s 1H FY15 reported numbers.

The company currently has net debt to common equity of 0.52x. Assuming that Falcon finances the current estimated consideration of S\$247.5m entirely via bank borrowings, the company’s net gearing may rise to 1.24x. However, the funds for the acquisition can potentially be supported by a S\$500m multicurrency medium term note programme, which Falcon announced in September 2014. Thus far, the company has only drawn down S\$50m of the facility, at an interest rate of 5.5% per annum.

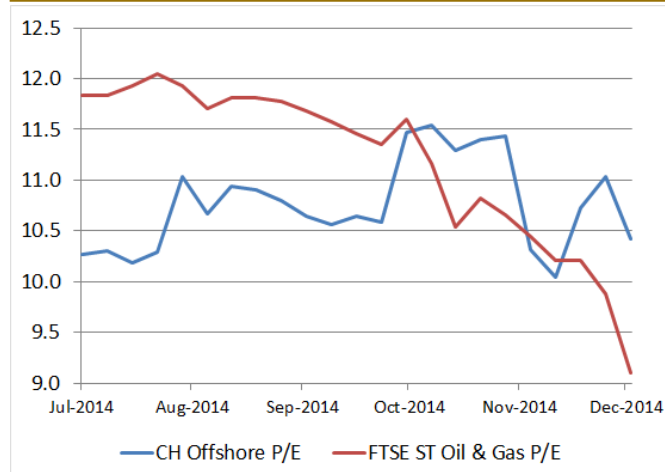
Our updated model values Falcon at S\$0.555 per share. Further terms and conditions about the acquisition will be included in Falcon’s offer document to CHO shareholders. The board of CHO will in turn issue a circular to shareholders, which will also contain their independent financial advisor’s recommendations. The information contained in these documents may potentially impact CHO shareholders’ take up of Falcon’s offer. We also do not rule out the possibility that Falcon may not be able to fully acquire CHO. As such, we remain prudent by not prematurely factoring in the acquisition of CHO in our forecasts, pending its completion.

Figure 1: FTSE ST Oil & Gas P/E vs WTI Crude Oil Price (Jan 2010 – Dec 2014)



Source: Bloomberg, Voyage Research

Figure 2: CH Offshore P/E vs FTSE ST Oil & Gas P/E (Jul 2014 – Dec 2014)



Source: Voyage Research

Figure 3: Valuation

US\$m	FY14	FY15F	FY16F
Revenue	350.79	272.12	179.17
EBIT	113.45	57.98	52.00
Tax on EBIT	-6.41	-4.06	-3.64
Minority Interest	-41.35	-4.00	-4.00
NOPLAT	65.69	49.92	44.36
Total Invested Capital		385.96	456.75
WACC		8.3%	8.3%
Capital Charge		-32.06	-37.95
Economic Profit		17.86	6.41
Terminal Value			103.73
Discount Factor		0.92	0.85
Present Value		16.49	5.47
Book Value	241.77		
Explicit Value	21.96		
PV of Terminal Value	88.43		
Value of Equity	352.15		
Proceeds from Warrants	26.91		
Total Value of Equity	379.06	Risk Free Rate	2.5%
No of Shares o/s	812.42	Market Risk Premium	7.5%
No of Warrants o/s	81.97	Cost of Equity	10.8%
Shares + Warrants	894.39	Cost of Debt	5%
Value per Share (US\$)	0.424	Terminal Growth	2%
Value per Share (S\$)	0.555	USD SGD	1.31

Source: Voyage Research

Figure 4: Forecasts and Valuation

US\$m	FY11	FP13	FY14	FY15F	FY16F
Revenue	79.95	116.20	350.79	272.12	179.17
Gross Profit	17.86	33.01	117.02	81.64	66.29
Net Income Before Taxes	7.08	-1.70	108.24	49.60	43.23
Net Income After Taxes	5.56	-2.40	102.12	46.13	40.20
Total Current Assets	76.56	92.85	216.97	159.76	162.75
Total Non-Current Assets	291.76	295.25	358.23	375.86	400.86
Total Current Liabilities	67.91	74.74	179.41	97.09	97.09
Total Non-Current Liabilities	102.98	118.06	136.56	138.07	138.07
Total Equity	197.44	195.31	259.23	300.47	328.46
Cash from Operating Activities	-16.09	16.05	149.46	26.82	33.30
Cash from Investing Activities	-14.13	-31.00	-88.98	-13.73	-21.10
Cash from Financing Activities	31.08	14.52	-32.76	12.53	-12.21
Net Change in Cash	0.86	-0.43	27.71	25.63	-0.02
Net Cash - Beginning Balance	12.30	13.10	12.90	40.60	66.23
Net Cash - Ending Balance	13.10	12.90	40.60	66.23	66.21
Inventory Days	58	39	1	2	4
Receivable Days	164	179	127	170	177
Payable Days	93	113	115	143	83
ROE	2.9%	-1.3%	47.7%	17.7%	13.8%
ROA	1.7%	-0.6%	21.2%	8.3%	7.3%
Debt/Equity	69.4%	79.0%	73.5%	69.9%	64.4%
Current Ratio	1.13	1.24	1.22	1.65	1.68
P/E	44.61	-48.91	2.40	3.16	4.03
P/B	0.77	0.78	0.60	0.52	0.48

Source: 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.

IMPORTANT DISCLOSURE:

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