

Falcon Energy Group Limited

Offer Worth a Second Look

Falcon Energy Group Limited's (Falcon) Offer for CH Offshore Ltd (CHO) shares, made via subsidiary Energian Pte Ltd, will close at 5.30 pm next Monday (26 January 2015). In the circular issued on 8 January 2015, the independent directors of CHO have recommended shareholders to reject the Offer and the Independent Financial Adviser (IFA) has advised that the financial terms of the Offer are not fair and not reasonable. Our observations, based on the contents of the circular and additional information gathered, suggests that the Offer may be worth further thought.

Offer Price is Pegged at Rich P/E Multiple: The Offer Price is equivalent to 12.1 times CHO's trailing 12-month earnings, which is 81.4% higher than the adjusted five year daily average traded P/E of CHO of 6.66 times and 85.9% higher than the mean P/E of its set of comparable peers of 6.5 times. We find the P/E multiple built into the Offer Price somewhat rich compared to the five-year 25th percentile to 75th percentile range of 4.88 times to 7.60 times and the peer range of 3.30 times to 10.30 times.

Earlier P/NTA Not Adjusted For Dividend Payment: The Offer Price is equivalent to 1.08 times CHO's net asset value as of 30 September 2014. However, CHO subsequently paid out 4.5 S cents of dividend per share on 19 November 2014. Adjusting CHO's NAV per share to reflect the payment of this dividend, the Offer Price will translate to about 1.20 times the adjusted NTA of S\$0.412 and is well above the five year median of 1.055 times and higher than the average of 1.096 times.

Current Market Prices May Not Sustain in Absence of Offer: Since the announcement of the Offer, some shareholders may have been able to sell their shares in the open market at prices higher than the Offer. However, market liquidity and bid prices for CHO shares may decline if the Offer were to lapse and no further offers were made. As such, the Offer is still a low cost exit option for CHO shareholders. The above are just part of our observations, which are more fully explained in the subsequent parts of our report.

Increase Exposure

- Intrinsic Value S\$0.555
- Prev Close S\$0.285

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	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	3.75
P/BV	0.57
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 809.50m

Market Capitalization S\$230.7m

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Current Market Prices May Not Sustain in Absence of Offer: CHO shares' daily closing price since 10 December 2014 to 22 January 2015 averaged at S\$0.514 and ranged between S\$0.500 and S\$0.520. As such, market conditions have most likely allowed some shareholders to sell their holdings at prices higher than the Offer Price of S\$0.495.

Nonetheless, we also point out that the Offer Price is still at a premium above the volume weighted average prices (VWAP) of various periods prior to the offer. As stated in the 8 January 2015 circular, the Offer Price represents premia of 7.9% and 8.1% above the VWAP of S\$0.459 and S\$0.458 for the 1-year and 1-month periods prior to the announcement of the Offer.

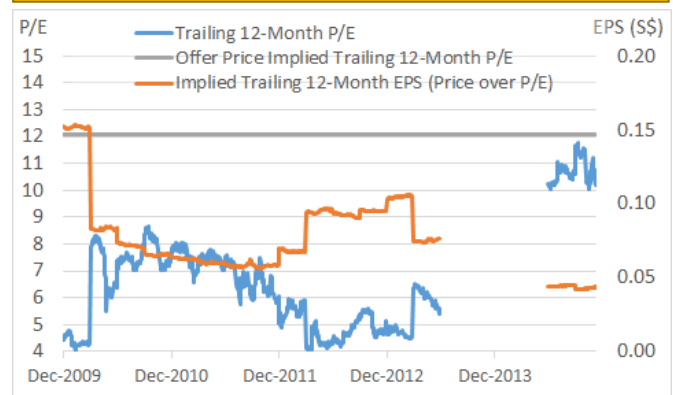
As the announcement of the Offer may have been the trigger for CHO shares to trade at above S\$0.500, we may see some share price weakness if the Offer were to lapse and no further offers were made by Falcon or any competing party. As such, we still see the Offer as a convenient exit option for CHO shareholders without having to consider about transaction costs, market volatility and trading volume.

Figure 1: CHO Share Price (31 December 2009 – 22 January 2015)



Source: Bloomberg, Voyage Research

Figure 2: CHO Trailing 12-Month P/E and Implied EPS (31 Dec 2009 – 10 Dec 2014)¹



Source: Bloomberg, Voyage Research

Rich P/E Multiple Offered Despite Prior Periods of Negative Earnings Growth:

Accordingly, the Offer Price translates to a trailing 12-month P/E of 11.4 times. When factoring in CHO's 2Q FY2015 results for the quarter ended 31 December 2014, the Offer Price implied trailing 12-month P/E is raised to 12.1 times. In terms of CHO's FY2014 earnings, the Offer Price is about 10.6 times P/E. In contrast, CHO traded between 4.88 times (25th percentile) and 7.60 times (75th percentile) trailing 12-month P/E over the last five years, defined as 31 December 2009 to 10 December 2014 (immediately prior to the announcement of the Offer) inclusive.¹

¹When comparing historical P/E information, we do not take into account the trailing 12-month P/E of CHO shares from 28 June 2013 to 27 June 2014 as the trailing 12-month P/E spiked up from 5.45 times on 27 June 2013 to 79.1 times on 28 June 2013 due to losses reported in FY2013. During

The fact that the Offer's implied trailing 12-month P/E is at a 81.4% premium compared to its five-year historical average of 6.66 times when CHO's profitability in its most recent financial year is still substantially lower than historical levels is a potential factor for CHO shareholders to consider when deciding on the Offer. CHO's FY2014 net profit is about 27.9% lower than the three-average of US\$34.8 million during FY2010 – FY2012.

Figure 3: Financial Summary of CHO and P/E Summary Statistics

Summary of Historical Trailing 12-Month P/E

	Min	25th Percentile	Median	75th Percentile	Max	Average
Period A	10.04	10.32	10.64	10.93	11.76	10.72
Period B	4.00	4.88	6.43	7.60	11.76	6.66

Period A 30 June 2014 - 10 December 2014

Period B 31 December 2009 - 10 December 2014, excluding 28 June 2013 - 27 June 2014

Financial Summary

US\$ m	FY2010	FY2011	FY2012	FY2013	FY2014	6M 2014	6M 2015
Revenue	63.12	58.55	51.51	47.82	35.14	17.07	17.86
Gross Profit	40.35	33.44	29.03	32.53	23.32	11.87	11.42
Share of results of associated companies	0.54	1.42	4.31	7.41	5.37	4.00	1.76
Profit / (Loss) after tax	37.34	33.59	33.43	-7.11	25.08	14.10	11.01

6M 201X refers to the six months ended December 201X.

Source: Bloomberg, Voyage Research

Combined Entity to Increase Earnings Stability: Notwithstanding Falcon's intention whether to privatize or delist CHO if it is successful in gaining control, we see the combination of both companies under a larger entity as a positive. Based on the review of CHO's financial performance for FY2013 and FY2014, we noticed that CHO's revenue and profitability have been in the past adversely affected by vessel downtime and changes in charter arrangements from time to time.

Vessel downtime refers to vessels not being utilized due overhaul, upgrading and repair works, while changes in charter arrangements, such as from time charter to bareboat charter, may reduce (or increase) revenue. Referring to CHO's commentary contained in the FY2014 financial results announcement, four vessels, equivalent to 27% (in terms of vessel count) of CHO's entire fleet of nine wholly-owned and six co-owned vessels, are expected to undergo mandatory docking for major overhaul in the "next 12 months", which we interpret to most likely be referring to the July 2014 to June 2015 period.

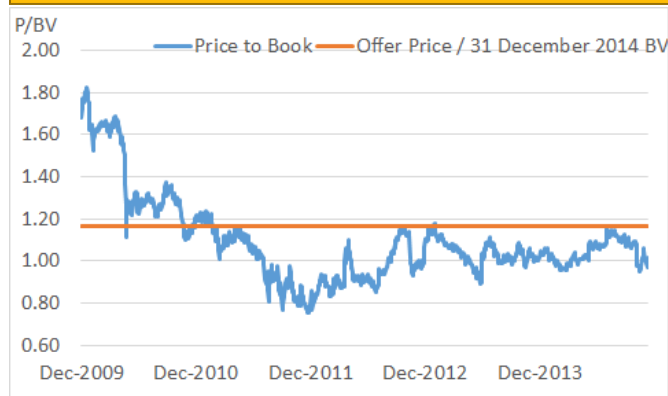
Therefore, we envisage that a larger entity with a bigger fleet will be able to better rotate ship maintenance works to reduce the impact of vessel downtime or off-hire time on revenue and profitability, thus increasing financial performance stability.

this period, trailing 12-month P/E ranged from 75.6 times to 213.6 times with negative trailing 12-month earnings from 2 January 2014 to 27 June 2014. As such, we can regard the P/E data from 28 June 2013 to 27 June 2014 as not meaningful.

Offer Price Translates to 20% Premium Above Adjusted Book Value: We further noticed that CHO had declared total dividends of 4.50 S cents in its FY2014 financial results announcement. These dividends were paid on 19 November 2014. Therefore, we adjusted the NTA per share of CHO as of end September 2014 to reflect the payment of these dividends and reduced NTA per share by S\$0.045 from S\$0.457 as of end September 2014 to S\$0.412 (ANTA).

Based on the ANTA, the Offer Price is equivalent to a P/ANTA of 1.20 times. As of 31 December 2014, CHO had a net asset value per share of US\$0.3241 or S\$0.4255 (announced subsequent to the latest practicable date of the circular), based on an exchange rate of US\$1.00: S\$1.313. Based on the latest (December 2014) NTA or NAV (LNTA), the Offer Price still offers a premium of 16.3%, rather than the initial 8.3% premium when compared to the reported 30 September 2014 NTA.

Figure 4: Summary Statistics and Historical Chart of CHO P/BV



Source: Bloomberg, Voyage Research

	Period A	Period B
Min	0.95	0.76
25th Percentile	1.00	0.98
Median	1.04	1.05
75th Percentile	1.08	1.14
Max	1.15	1.83
Average	1.04	1.10

Period A: 1 Jan 2014 to 10 Dec 2014

Period B: 31 Dec 2009 to 10 Dec 2014

Figure 4: The Offer Price to LNTA ratio is 10.3% higher than the five year median and 6.1% above the five year average.

Figure 5: Comparison of Selected Companies Broadly Comparable to CHO

	Trailing 12-Month P/E	Current P/BV		Trailing 12-Month P/E	Current P/BV
POSH	6.73	0.69	EMAS Offshore	3.30	0.78
Pacific Radiance	7.36	1.11	Marco Polo Marine	10.30	0.91
Vallianz	6.37	1.00	Atlantic Navigation	4.97	0.58
			Average	6.50	0.84
			Median	6.55	0.84
CHO Offer Price - Based on Financials up to 31 Dec 2014				12.09	1.16
CHO Offer Price - Based on Financials up to 30 Sep 2014				11.4	1.08

For Figure 5, we relied on the same set of industry peers as identified in the circular. The financial ratios for EMAS Offshore are not available on Bloomberg and we obtained them from http://emasoffshore.listedcompany.com/financial_ratios.html, with P/BV calculated based on a share price of 0.515 versus NAV per share of S\$0.6644. For other companies, except CHO, the financial ratios were extracted from Bloomberg on 22 January 2015.

Source: Bloomberg, Voyage Research

Premium for Majority Control Deserves Further Study: Applying the revaluation surplus (S\$0.114) provided by the circular to CHO's 31 December 2014 NTA, we arrived at a revalued NTA (LRNTA) of S\$0.539 per share. The offer price works out to about 91.8% of the LRNTA or a discount of 8.2%, as compared to the premium of 16.3% above the LNTA.

To reconcile the different Offer discount and premium obtained when comparing between P/LRNTA and P/LNTA, we referred to the shorter list of selected offers (majority control peer set) that were used to compare the premia paid for majority control. Referring to the respective circulars in these offers, we noticed that the offer prices were often compared with a model driven valuation or its variant, such as the sum-of-parts valuation methodology, to revalue balance sheet items, as well as with valuation multiples based on reported financial information such as trailing 12-month P/E. Such an approach provides perspectives from both the revalued NAV and the reported NAV or earnings of the targets.

While we do not attempt to value CHO, we compared the Offer Price to LRNTA ratio (at 0.92) to the average P/RNTA (mean 0.92) of the selected companies and found that most offer prices were on average 8.2% below RNTA, similar to the Offer Price's discount to the LRNTA. Therefore, we can argue that the Offer Price may not necessarily be too low even though the P/LNTA (at 1.16) may be below the average (1.36, excluding Goodpack) derived from the majority control peer set. Even so, the P/LNTA is still 38.1% higher than the average for the comparable peer set (Figure 5). As such, we can infer that some premium for majority control has already been factored into the Offer Price

Figure 6: Selected Offers to Estimate Premium for Majority Control

	Offer Price	Valuation *	P/Valuation	NTA	P/NTA	Source
WBL Corporation Limited	4.45	4.91	0.91	3.14	1.42	Circular dated 14 January 2014
Olam International Limited	2.23	1.75	1.27	1.24	1.80	Circular dated 17 April 2014
Hotel Properties Limited	4.05	5.23	0.77	3.08	1.31	Letter dated 5 June 2014
ASJ Holdings Limited	0.065	0.091	0.71	0.072	0.90	Circular dated 9 June 2014
Goodpack Limited	2.50	NA		0.81	3.09	Document dated 30 July 2014
	Mean		0.92	Mean	1.70	
	Median		0.84	Median	1.42	
			Mean (excluding Goodpack)		1.36	
			Median (excluding Goodpack)		1.37	
CH Offshore	0.495	0.539	0.92	0.426	1.16	

For Figure 6, we relied on the same set of comparable offers as identified in the circular. However, we organized the multiples such that multiples based on historical financial information and multiples based on revalued net assets are compared separately.

*Basis of valuation, as extracted from respective documents - WBL: midpoint of sum-of-parts valuation, Olam: mean of broker research price targets prior to offer announcement date, Hotel Properties: RNAV, based on gross development value, ASJ Holdings: RNAV, based on realizable value of selected assets. We were unable to find a RNAV from the Goodpack scheme document.

Source: Bloomberg, Voyage Research

Offer Deserves Further Consideration: To conclude, the Offer Price may be more attractive if we consider it relative to the latest available trailing 12-month earnings and net asset value information, and across a longer time period of up to five years. Based on the RNAV of selected offers (Figure 6), acquiring for majority control does not necessarily require paying a premium above RNAV. However, some premium above the “raw” NAV may be required and may possibly vary from industry to industry.

We also question if lower oil prices, an ongoing market theme, will impact the outlook of CHO. For instance, lower oil prices have led to reductions in new investments in the oil and gas industry and may potentially have an impact on CHO.

That said, we emphasize that the objective of this report is to provide certain observations that arose as a result of the ongoing Offer, for general consideration and is not targeted at CHO shareholders. We are mindful that we did not consider as many factors as taken into account by the IFA, such as dividend track record. Therefore, our views contained herein should not be construed as advice in relation to the acceptance or rejection of the Offer. Likewise, we also do not provide an opinion about the fairness and the reasonableness of the Offer Price.

As the focus of this report is not on Falcon, we leave our recommendation, forecasts and valuation of Falcon unchanged from our last update and do not replicate them in this report.

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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