

Falcon Energy Group

Expect more from the Marine Division

Falcon Energy Group (Falcon) recorded an extraordinary 2Q results with revenue rising 9.3X QoQ to US\$184m while PAT soared 36X QoQ to US\$77m. These figures were mainly boosted by the disposal of two jack-up rigs which amount to US\$128m revenue and US\$71.5m gross profit. The sale resulted in an attributable net PATMI of US\$29m to the group. That said, the group generated about US\$10m of operating PATMI in 2Q, substantially higher than our previous forecast of US\$5m.

We currently forecast Falcon to report about US\$7m operating PATMI quarterly and there maybe upside surprises to our forecast, in view of the positive marine and drilling division outlook. We have revised our FY14 and FY15 numbers upward slightly and resulted in a higher intrinsic value of S\$0.575. Maintain **Increase Exposure**.

Results Summary: Operating revenue rose 212% YoY to US\$55.7m mainly due to one-off contracts in the Oilfield Services Division and higher utilization rate in the Marine Division. Operating gross profit climbed 114% YoY to US\$10.1m mainly backed by higher revenue in the two mentioned divisions. Operating expenses inched down slightly YoY due to effective cost control while the group recognized lower profit from associates, mainly due to CH Offshore. Consequently, PBT rose 35X to US\$78.6m.

For the 1H of 2014, PPE rose by US\$35m HoH to US\$221m mainly due to the purchase of a new vessel and office premises while current deposits and receivables increased by US\$53m HoH to US\$105m as a result of installments paid for the rigs. The sale of the rigs probably led to higher current payables, which jumped US\$42m to US\$58m.

Net borrowings climbed by US\$24m mainly for the purchase of PPE and expansion of business activities. Falcon also recommended an interim dividend of 0.5 S cent in view of the robust results.

Increase Exposure

- Intrinsic Value S\$0.575
- Prev Closing Price S\$0.410

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	FY11	FY12*	FY14F
Revenue	80.0	116	265
Gross Profit	17.9	33.0	113
PAT	7.1	10.4	86.8
EPS (US cts)	0.4	1.2	6.1

*: 5 quarters

Source: Voyage Research Estimates

Key ratios (FY15F)

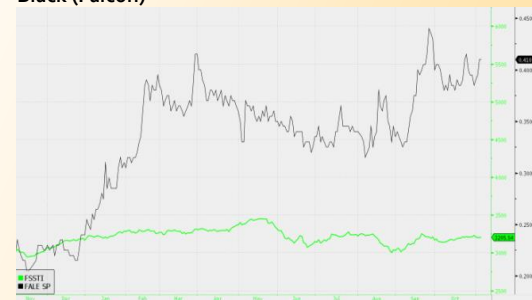
PER	9.0
P/BV	1.0
ROE	11.4%
Debt/Equity	63%
Current ratio	2.3

Source: Voyage Research Estimates

Indexed Price Chart

Green (FSSTI)

Black (Falcon)



Source: Bloomberg

52wks High-Low 45.5 cents/ 20.5 cents

Number of Shares 814m

Market Capitalization S\$334m

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Figure 1: Segment Numbers

Revenue (US\$m, CY)	1Q 2011	2Q 2011	3Q 2011	4Q 2011	1Q 2012	2Q 2012	3Q 2012	4Q 2012	5Q 2012	1Q 2014	2Q 2014
Marine	2.88	1.80	6.69	11.61	8.58	9.55	10.42	16.03	8.75	16.98	17.84
Oilfield Services	10.19	7.58	15.30	10.50	23.98	3.56	5.40	6.33	6.84	7.19	35.84
Oilfield Projects	3.31	3.34	3.38	3.37	3.34	3.34	2.01	2.02	6.04	2.00	2.02
Drilling											127.80
Gross Profit (US\$m)											
Marine	-1.32*	-2.19*	2.25	0.66	2.09	1.85	3.06	9.60	-1.41	7.03	5.51
Oilfield Services	2.51*	2.27	2.59	3.56	2.04	1.15	1.04	1.87	1.98	1.62	4.06
Oilfield Projects	1.84	1.94*	1.88	1.87	1.95	1.95	0.63	0.64	4.60	0.64	0.58
Drilling											71.44

*: Voyage Estimates

Source: Voyage Research

Company Update: Falcon experienced stable vessel utilization rate for 1H 2014, at about 75%. The figure is expected to improve to 85% in 2H 2014, probably backed by the entry of new vessels which are already contracted. Thus, we expect the division to contribute more in 2H 2014 and conservatively project a quarterly PAT of US\$7m for Falcon. For FY15, Falcon is likely to add another three to four vessels to the marine fleet.

The Oilfield Services and Oilfield Projects divisions' performance is likely to be the same in 2H as compared to 1H while the resource division has gathered about 150m-200m tonnes of coal reserve. Falcon is looking to commence coal production in the 1H of CY2014 if coal prices stay stable or move up.

The exciting part of this quarter's result is the one-off profit from the sale of two jack-up rigs, which amount to about US\$29m attributable profit for Falcon. Management commented that they are looking to work with a few partners to establish a drilling company. The intention is not to speculate but to charter out the rigs and in the long term, to spin off the entire division into a separate company. Of course, the consortium will not mind selling the rigs if the price is right.

Forecast and Summary: We are now adjusting our FY14 revenue to US\$265m to take into account the sale of the rigs – Falcon recognized only part of the rig's value as it is not fully constructed. That said, we now forecast the company to report operating PATMI of US\$28m for FY14. For 2015F, we upped our revenue and PAT due to the better marine division and drilling division outlook. We also upped the cost of equity to account for the risk from the drilling division. Maintain **Increase Exposure** with a higher intrinsic value of S\$0.575.

Figure 2: Economic Profit Valuation				
US\$ '000	2011	5Q 2012	2014F	2015F
EBIT	10982	17512	95239	40619
Tax on EBIT	-2369	-1097	-3810	-3249
Deferred Tax Liability	-1060	405	0	0
Minority Interest	-2282	-591	-37500	-500
NOPLAT	5271	16229	53930	36869
Total Invested Capital	282459	305967	337903	446873
WACC	7.9%	8.1%	7.0%	7.0%
Capital Charge	22191	24676	23608	31221
Economic Profit			30322	5648
Terminal				145929
Discount Rate			1.00	0.93
Present Value			30322	5279
Book Value	208081			
Explicit Value	30322		Risk Free	2.5%
Terminal Value	136399		MRP	7.5%
Value of Firm	374802		Cost of Equity	10.00%
Number of Shares	814200		Cost of Debt	5.0%
Value per Share (US\$)	0.460		Terminal G	3.0%
US Dollar Conversion	1.25			
Value in S\$	0.575			

Source: Voyage Research

Figure 3: Financial Forecasts and Estimates

US\$ '000	2010	2011	5Q 2012	2014F	2015F
Revenue	64610	79949	116195	265039	146168
Gross Profit	24615	17858	33005	112642	55544
Net Income Before Taxes	12151	7084	11075	90409	32744
Net Income After Taxes	11684	5556	10381	86792	30124
Total Current Assets	49872	76558	93060	181757	198281
Total Non-Current Assets	248460	291758	307777	335850	348849
Total Current Liabilities	33337	67909	74743	87322	86722
Total Non-Current Liabilities	69719	102969	118013	135412	135411
Total Equity	195276	197438	208081	294873	324997
Net Income Before Tax	12151	7084	11075	90409	32744
Cash from Operating Activities	15692	-16087	16050	57145	25757
Cash from Investing Activities	-117967	-14134	-30998	-45573	-11100
Cash from Financing Activities	67378	31080	14522	27955	0
Net Change in Cash	-34897	859	-426	39527	14657
Net Cash - Beginning Balance	47054	12303	13097	12896	52423
Net Cash - Ending Balance	12303	13097	12896	52423	67080
Inventory Days	6	58	39	30	105
Receivable Days	204	164	179	111	213
Payable Days	91	93	113	60	104
ROE	6.4%	2.9%	5.4%	38.8%	11.4%
ROA	4.5%	1.7%	2.7%	18.9%	5.7%
Debt/Equity	50.1%	69.4%	73.9%	70.5%	63.0%
Current Ratio	1.50	1.13	1.25	2.08	2.29
P/E	23.6	81.6	27.3	5.4	9.0
P/B	1.4	1.4	1.3	1.1	1.0

Source: Voyage 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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