

Singapore Company Focus

Vard Holdings

Bloomberg: VARD SP | Reuters: VARD.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

16 Oct 2015

FULLY VALUED (Downgrade from HOLD)

Last Traded Price: S\$0.45 (STI : 3,015.14)

Price Target : S\$0.38 (-15% downside) (Prev S\$0.39)

Reason for Report : Profit warning

Potential Catalyst: Strong oil price rebound, M&A activities

Where we differ: Earnings estimates lower than consensus; more conservative on margins

Analyst

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Price Relative



Forecasts and Valuation

FY Dec (NOK m)	2013A	2014A	2015F	2016F
Revenue	11,155	12,923	10,267	8,405
EBITDA	686	429	93	175
Pre-tax Profit	497	238	(327)	(29)
Net Profit	357	349	(76)	4
Net Pft (Pre Ex.)	366	349	(76)	4
EPS (S cts)	5.2	5.0	(1.1)	0.1
EPS Pre Ex. (S cts)	5.3	5.0	(1.1)	0.1
EPS Gth (%)	(56)	(2)	nm	nm
EPS Gth Pre Ex (%)	(54)	(5)	nm	nm
Diluted EPS (S cts)	5.2	5.0	(1.1)	0.1
Net DPS (S cts)	0.0	0.0	0.0	0.0
BV Per Share (S cts)	53.3	59.7	58.6	58.7
PE (X)	8.6	8.8	nm	707.7
PE Pre Ex. (X)	8.4	8.8	nm	707.7
P/Cash Flow (X)	nm	4.5	nm	1.0
EV/EBITDA (X)	10.3	23.5	113.0	43.0
Net Div Yield (%)	0.0	0.0	0.0	0.0
P/Book Value (X)	0.8	0.7	0.8	0.8
Net Debt/Equity (X)	1.1	1.9	2.3	1.6
ROAE (%)	10.4	8.9	(1.8)	0.1
Earnings Rev (%)			(175)	(94)
Consensus EPS (S cts)			3.3	3.2
Other Broker Recs:		B: 0	S: 7	H: 1

ICB Industry : Oil & Gas

ICB Sector: Industrial Transportation

Principal Business: STX OSV is a leading global builder and designer of advanced, high-spec offshore support vessels.

Source of all data: Company, DBS Bank, Bloomberg Finance L.P

More pain in the offing

- **Issues profit warning to flag worse-than-expected results in 3Q15/ FY15**
- **Facing steeper-than-expected learning curve for later production stages of LPG carriers at Promar yard in Brazil**
- **We cut earnings to now reflect net losses for 3Q15 as well as full-year FY15 in view of operational challenges**
- **Downgrade to FULLY VALUED, TP S\$0.38**

Chances of more red ink. Vard issued a profit warning with regards to its upcoming 3Q15 results where it noted that the operational challenges in Brazilian yards have continued and had a bigger-than-expected negative impact on profitability during 3Q15. This will materially affect numbers for full-year FY15 as well. Under the circumstances and following checks with management, we now expect another round of red ink for Vard in 3Q15, with a likelihood of losses at the EBITDA level as well, as seen in 3Q14.

New yard in Brazil a recurring headache. To recap, Vard is in the process of building six LPG carriers at its new Promar yard in Brazil (the other two in Niteroi), and is at the later production stages of the first few vessels. This is where we believe the learning curve has turned out steeper than earlier envisaged, and Vard may have incurred additional cost overruns owing to fairly inexperienced staff and supervisors. It is now reasonable to expect delays in the LPG carrier delivery schedule. The one silver lining is that despite political and economic issues in Brazil and Petrobras, there have been no problems in payments so far from customer Transpetro.

Downside risks to earnings, order wins. We now expect Vard to record a net loss of NOK76m in FY15, and breakeven at best in FY16 if Brazil performance improves to an extent (from NOK100m and NOK73m net profit earlier respectively). The other big concern for Vard is the slowdown in order wins with low oil prices affecting demand for deepwater offshore vessels. YTD in FY15, Vard has secured only about NOK1.8bn new contracts, and we lower our FY15/16 new order win assumptions from NOK5bn/7bn to NOK3bn/5bn respectively. Vard may be looking to further diversify its product offerings but that would involve a learning curve as well. In light of the uncertain outlook and earnings downside risks, downgrade to FULLY VALUED; TP of S\$0.38 pegged to 0.7x P/BV.

At A Glance

Issued Capital (m shrs)	1,180
Mkt. Cap (S\$m/US\$m)	525 / 381
Major Shareholders	
Fincantieri Oil & Gas SPA (%)	55.6
Kairos Investment Management (%)	5.0
Free Float (%)	39.4
3m Avg. Daily Val (US\$m)	0.91

INVESTMENT THESIS

Profile	Rationale
<p>VARD is a major global shipbuilder that constructs complex and highly customised offshore support vessels. The Group has 10 shipbuilding facilities worldwide - in Norway, Romania, Brazil and Vietnam.</p>	<p>Weak order win outlook. Vard has been able to secure only NOK1.5bn new order wins YTD in FY15. Management reiterated that the market for new orders remains very challenging, the North Sea market in particular.</p> <p>Our new order win assumptions for Vard in FY15/16 are lowered to NOK3bn and NOK5bn from NOK5bn and NOK7bn respectively. Vard may be looking to diversify its offerings away from offshore vessels to include more specialised fishing boats, ice breakers and some military vessels but new vessel types imply a learning process all over again.</p> <p>Cost-cutting measures in place. As utilisation rates in European yards are expected to come off from 2HFY15 onwards, management has put in place measures to reduce overheads and labour. We expect operating costs to decline owing to reduction of work force but there will be associated restructuring costs in the near term.</p> <p>Uncertainty on margin recovery trend. Further cuts in earnings necessitated by continuing operating issues at Brazilian yards, especially the new Promar yard. EBITDA margins recovery trend is likely to be slower than earlier expected owing to continued cost overruns in Brazil owing to steep learning curve in the later production stages of the LPG carriers under construction. We now expect Vard to record a net loss of NOK76m in FY15, and break even at best in FY16 if Brazil performance improves to an extent (from NOK 100m and NOK73m net profit earlier respectively).</p>
Valuation	Risks
<p>In light of uncertain order win outlook and weak earnings trajectory hereon, we downgrade our call from HOLD to FULLY VALUED with a target price of S\$0.38, pegged to 0.7x FY15 P/BV, which reflects the sub-par return (ROE) expectations in FY15/16. The current orderbook of NOK12bn does underpin some revenue visibility in FY15/16 but that is more than offset by the execution issues at the Brazilian yards and the weak Kroner.</p>	<p>Upside risks: earnings rebound, order pick-up, corporate activity. The key risk to our FULLY VALUED call is if margin recovery and order win momentum is significantly earlier than we anticipate, which could help re-rate the stock. A sharp oil price recovery will also boost share price. Any corporate activity related to majority shareholder Fincantieri in terms of buying additional stake in the company at premium valuations could also be an upside catalyst.</p>

Source: DBS Bank

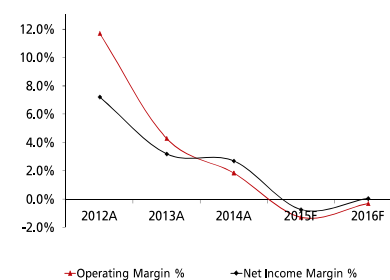
Key Assumptions

FY Dec	2012A	2013A	2014A	2015F	2016F
Annual order intake (NOK m)	9,501	14,174	9,450	3,000	5,000
Adjusted EBITDA margins (%)	13.2	6.15	3.32	0.91	2.08

Further downside possible

Income Statement (NOK m)

FY Dec	2012A	2013A	2014A	2015F	2016F
Revenue	11,129	11,155	12,923	10,267	8,405
Cost of Goods Sold	(7,154)	(7,778)	(9,457)	(7,145)	(5,884)
Gross Profit	3,975	3,377	3,466	3,122	2,522
Other Opng (Exp)/Inc	(2,670)	(2,897)	(3,226)	(3,251)	(2,546)
Operating Profit	1,305	480	240	(130)	(25)
Other Non Opng (Exp)/Inc	(37)	(25)	(51)	(202)	0
Associates & JV Inc	(98)	9	35	19	30
Net Interest (Exp)/Inc	40	42	14	(15)	(34)
Exceptional Gain/(Loss)	15	(9)	0	0	0
Pre-tax Profit	1,225	497	238	(327)	(29)
Tax	(434)	(197)	(188)	(88)	(80)
Minority Interest	13	57	299	340	113
Preference Dividend	0	0	0	0	0
Net Profit	804	357	349	(76)	4
Net Profit before Except.	789	366	349	(76)	4
EBITDA	1,473	686	429	93	175

Margins Trend**Growth**

Revenue Gth (%)	(10.3)	0.2	15.8	(20.6)	(18.1)
EBITDA Gth (%)	(37.5)	(53.4)	(37.5)	(78.2)	87.6
Opg Profit Gth (%)	(40.9)	(63.2)	(50.0)	nm	80.9
Net Profit Pre-Ex Gth (%)	(51.6)	(53.6)	(4.6)	(121.6)	(105.8)

Minority interest refers to share of losses in Vard Promar shipyard

Margins & Ratio

Gross Margins (%)	35.7	30.3	26.8	30.4	30.0
Opg Profit Margin (%)	11.7	4.3	1.9	(1.3)	(0.3)
Net Profit Margin (%)	7.2	3.2	2.7	(0.7)	0.1
ROAE (%)	24.1	10.4	8.9	(1.8)	0.1
ROA (%)	6.3	2.7	2.1	(0.4)	0.0
ROCE (%)	12.2	3.4	0.4	(1.0)	(0.2)
Div Payout Ratio (%)	90.7	0.0	0.0	N/A	0.0
Net Interest Cover (x)	NM	NM	NM	(8.7)	(0.7)

Source: Company, DBS Bank

Vard Holdings

Quarterly / Interim Income Statement (NOK m)

FY Dec	2Q2014	3Q2014	4Q2014	1Q2015	2Q2015
Revenue	2,942	2,809	4,500	3,063	2,489
Cost of Goods Sold	(1,993)	(2,137)	(3,528)	(2,189)	(1,663)
Gross Profit	949	672	972	874	826
Other Oper. (Exp)/Inc	(809)	(780)	(887)	(865)	(847)
Operating Profit	140	(108)	85	9	(21)
Other Non Opg (Exp)/Inc	5	(62)	21	(208)	6
Associates & JV Inc	5	10	18	1	3
Net Interest (Exp)/Inc	5	6	(6)	(8)	(11)
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	155	(154)	118	(206)	(23)
Tax	(50)	(6)	(98)	(20)	(28)
Minority Interest	35	123	134	134	109
Net Profit	140	(37)	154	(92)	58
Net Profit before Except	140	(37)	154	(92)	58
EBITDA	198	(104)	153	(151)	35

Growth

Revenue Gth (%)	10.1	(4.5)	60.2	(31.9)	(18.7)
EBITDA Gth (%)	26.1	nm	nm	nm	nm
Opg Profit Gth (%)	13.8	nm	nm	(89.4)	nm
Net Profit Pre-Ex Gth (%)	52.2	(126.4)	(516.2)	(159.7)	(163.0)

Margins

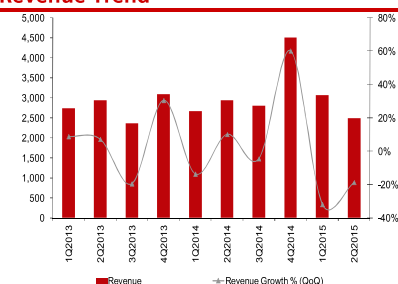
Gross Margins (%)	32.3	23.9	21.6	28.5	33.2
Opg Profit Margins (%)	4.8	(3.8)	1.9	0.3	(0.8)
Net Profit Margins (%)	4.8	(1.3)	3.4	(3.0)	2.3

Balance Sheet (NOK m)

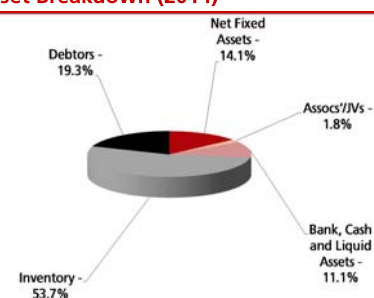
FY Dec	2012A	2013A	2014A	2015F	2016F
Net Fixed Assets	1,384	2,167	2,535	2,422	2,332
Invt in Associates & JVs	418	383	327	346	376
Other LT Assets	607	731	924	894	864
Cash & ST Invt	2,437	1,745	2,002	188	2,094
Inventory	5,967	6,661	9,666	8,932	5,884
Debtors	1,920	2,076	3,465	2,933	2,401
Other Current Assets	80	51	530	530	530
Total Assets	12,813	13,814	19,449	16,245	14,481
ST Debt	3,385	5,012	8,069	7,069	6,069
Creditor	4,319	3,616	5,694	4,009	3,363
Other Current Liab	1,096	595	370	266	258
LT Debt	545	673	1,204	1,204	1,204
Other LT Liabilities	252	210	248	248	248
Shareholder's Equity	3,151	3,688	4,132	4,056	4,061
Minority Interests	65	20	(268)	(608)	(721)
Total Cap. & Liab.	12,813	13,814	19,449	16,245	14,481
Non-Cash Wkg. Capital	2,552	4,577	7,597	8,120	5,194
Net Cash/(Debt)	(1,493)	(3,940)	(7,271)	(8,085)	(5,179)
Debtors Turn (avg days)	61.5	65.4	78.3	113.7	115.8
Creditors Turn (avg days)	240.1	191.2	183.3	255.8	236.7
Inventory Turn (avg days)	308.4	296.3	315.1	475.0	459.5
Asset Turnover (x)	0.9	0.8	0.8	0.6	0.5
Current Ratio (x)	1.2	1.1	1.1	1.1	1.1
Quick Ratio (x)	0.5	0.4	0.4	0.3	0.5
Net Debt/Equity (X)	0.5	1.1	1.9	2.3	1.6
Net Debt/Equity ex MI (X)	0.5	1.1	1.8	2.0	1.3
Capex to Debt (%)	10.1	14.4	4.0	1.0	1.1
Z-Score (X)	NA	1.1	0.9	0.9	1.0

Source: Company, DBS Bank

Revenue Trend



Asset Breakdown (2014)



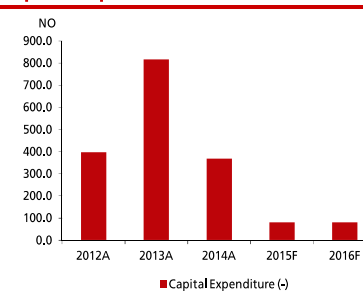
Balance sheet will improve as vessels are delivered

Cash Flow Statement (NOK m)

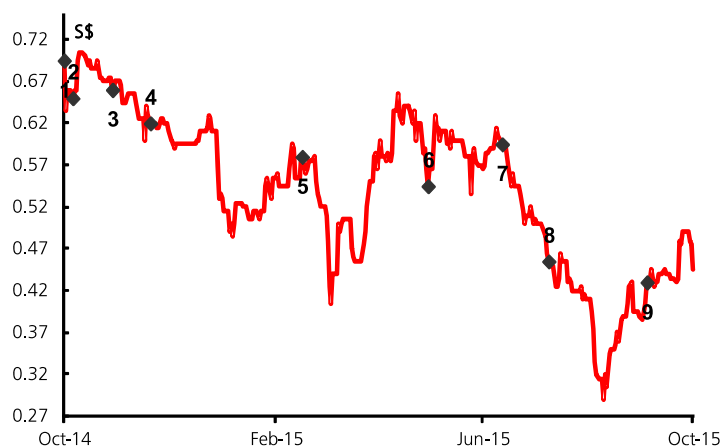
FY Dec	2012A	2013A	2014A	2015F	2016F
Pre-Tax Profit	1,225	497	238	(327)	(29)
Dep. & Amort.	168	206	189	223	200
Tax Paid	(766)	(412)	(209)	(192)	(88)
Assoc. & JV Inc/(loss)	98	(9)	(35)	(19)	(30)
Chg in Wkg.Cap.	272	(604)	460	(419)	2,933
Other Operating CF	(4)	(19)	47	0	0
Net Operating CF	993	(341)	690	(734)	2,986
Capital Exp.(net)	(398)	(816)	(367)	(80)	(80)
Other Invts.(net)	(129)	(16)	0	0	0
Invts in Assoc. & JV	(17)	(15)	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	(87)	(6)	(498)	0	0
Net Investing CF	(631)	(853)	(865)	(80)	(80)
Div Paid	(1,278)	(1)	0	0	0
Chg in Gross Debt	321	417	423	(1,000)	(1,000)
Capital Issues	0	14	0	0	0
Other Financing CF	(9)	52	(36)	0	0
Net Financing CF	(966)	482	387	(1,000)	(1,000)
Currency Adjustments	(23)	20	45	0	0
Chg in Cash	(627)	(692)	257	(1,814)	1,906
Opg CFPS (NOK)	0.6	0.2	0.2	(0.3)	0.0
Free CFPS (NOK)	0.5	(1.0)	0.3	(0.7)	2.5

Source: Company, DBS Bank

Capital Expenditure



Target Price & Ratings History



Note : Share price and Target price are adjusted for corporate actions.

S.No.	Date	Closing Price	Target Price	Rating
1:	15 Oct 14	0.70	0.65	FULLY VALUED
2:	20 Oct 14	0.65	0.65	FULLY VALUED
3:	12 Nov 14	0.66	0.63	FULLY VALUED
4:	04 Dec 14	0.62	0.51	FULLY VALUED
5:	02 Mar 15	0.58	0.51	FULLY VALUED
6:	14 May 15	0.55	0.49	FULLY VALUED
7:	26 Jun 15	0.60	0.49	FULLY VALUED
8:	23 Jul 15	0.46	0.45	FULLY VALUED
9:	18 Sep 15	0.43	0.39	HOLD

Source: DBS Bank

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STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return i.e. > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

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