

# Singapore Company Focus

## Sembcorp Marine

Bloomberg: SMM SP | Reuters: SCMN.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

2 Dec 2015

### FULLY VALUED (Downgrade from HOLD)

Last Traded Price: S\$2.06 (STI : 2,870.26)

Price Target : S\$1.85 (11% downside) (Prev S\$2.32)

Reason for Report : Profit warning, Rating/TP downgrade

Potential Catalyst: Sharp oil price recovery

Where we differ: In line

#### Analyst

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#### Price Relative



#### Forecasts and Valuation

FY Dec (\$m)	2014A	2015F	2016F	2017F
Revenue	5,833	4,630	4,698	4,960
EBITDA	829	609	755	802
Pre-tax Profit	707	438	522	543
Net Profit	560	353	418	432
Net Pft (Pre Ex.)	560	353	418	432
EPS (S cts)	26.8	16.9	20.0	20.7
EPS Pre Ex. (S cts)	26.8	16.9	20.0	20.7
EPS Gth (%)	1	(37)	18	3
EPS Gth Pre Ex (%)	4	(37)	18	3
Diluted EPS (S cts)	27.0	17.0	20.1	20.8
Net DPS (S cts)	13.0	8.45	10.0	10.3
BV Per Share (S cts)	142	146	157	168
PE (X)	7.7	12.2	10.3	10.0
PE Pre Ex. (X)	7.7	12.2	10.3	10.0
P/Cash Flow (X)	nm	nm	6.6	24.3
EV/EBITDA (X)	6.2	10.7	8.5	8.3
Net Div Yield (%)	6.3	4.1	4.9	5.0
P/Book Value (X)	1.5	1.4	1.3	1.2
Net Debt/Equity (X)	0.2	0.6	0.6	0.6
ROAE (%)	19.9	11.7	13.2	12.7

#### Earnings Rev (%)

Consensus EPS (S cts):

Other Broker Recs:

-  
16.7  
B: 3

-  
18.4  
S: 12

-  
18.5  
H: 7

ICB Industry : Oil & Gas

ICB Sector: Oil Equipment; Services & Dist

Principal Business: Principal activities are ship repair, shipbuilding, ship conversion rig building and offshore engineering.

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

### Slipping into the red

- Guiding for a net loss in 4Q15
- Prudent provisions for potential deferments / cancellations
- To get worse before it gets better; downside risk to DPS
- Downgrade to FULLY VALUED; TP cut to S\$1.85

**Warns for losses in 4Q15.** SMM has issued profit warnings that it expects a net loss for 4Q15, resulting in a significant y-o-y profit decline in FY15. The challenging operating environment and project deferments were cited as key culprits. Separately, regarding the purported termination of the jackup rig contract with Marco Polo, SMM has demanded the latter to pay the overdue second disbursement of 10% of the contract price (US\$21.43m) that has been deferred twice, as well as agreed interests.

**To get worse before it gets better.** We reckon the potential losses in 4Q15 are attributable to profit reversal and impairment for the 95% completed Marco Polo unit as well as prudent provisions for the higher risks of newbuild projects without back-to-back charter contracts. There may be more bad news to come - deferments, cancellations, asset deflation etc - in view of the prolonged oil crisis. Newbuild rig orders are unlikely to make a comeback any time soon as the rig supply glut will take time to be absorbed. The restructuring progress of SMM's single largest Brazilian customer Sete Brasil, who accounts for >40% of its orderbook, also appears slow and Petrobras' scandal continues to be an overhang.

**Downgrade to FULLY VALUED.** We are leaving our forecasts unchanged for now pending more colour on the provisions and delivery schedule. There is also downside risk to our existing DPS forecasts given the decline in earnings and rising gearing levels. We cut our TP to S\$1.85 based on a lower 1.2x P/BV (from 1.5x P/BV) on the back of lower ROEs that is projected to fall into the low teens; the lower TP implies 11% potential downside. Downgrade to FULLY VALUED.

#### At A Glance

Issued Capital (m shrs)	2,089
Mkt. Cap (\$m/US\$m)	4,304 / 3,050
Major Shareholders	
Sembcorp Industries Ltd (%)	61.0
Franklin Resources (%)	5.0
Free Float (%)	34.0
3m Avg. Daily Val (US\$m)	3.8

## INVESTMENT THESIS

Profile	Rationale
<p>Sembcorp Marine (SMM) is a pure play in the offshore &amp; Marine sector. Its principal activities are rig building and offshore engineering, ship conversion, ship repair and shipbuilding of specialised vessels.</p>	<p><b>Downgrade to FULLY VALUED.</b> We reckon order momentum will likely lag any oil price recovery amid the rig supply glut and keen competition. While SMM offers decent dividend yield of 4% on the back of 50% dividend payout, downside risk prevails given the earnings reduction and high gearing.</p> <p><b>More deferrals.</b> Brazilian projects are pushed back as Petrobras has slashed its 5-year capex by 41% and production target by 30%. Transocean recently deferred delivery of the pair of drillships under construction at SMM's yard by two years. There could be more of such deferrals which pose a risk to earnings, but this should be partially mitigated by compensation from customers.</p> <p><b>Slow order momentum.</b> YTD new contract wins of S\$3.1bn is commendable in the current climate. This was driven by the two sizeable contracts to build a fixed platform and the world's largest semi-submersible crane vessel. SMM's orderbook has inched up to S\$11.6bn as at end-Sep15, from S\$10.9bn in Jun-2015.</p>
Valuation	Risks
<p>Our target price of S\$1.85 is based on 1.2x SMM's FY16 P/BV, which represents a 20% discount to GFC trough valuation, given the lower ROEs.</p>	<p><b>Sustained low oil price.</b> Brent crude oil price below US\$60/bbl would defer investments into deepwater projects, and higher cost oilfield projects. This could dampen newbuild demand for drilling rigs especially floaters.</p> <p><b>Execution risks in a protected market.</b> Cost pressures, lack of skilled labour, potential project delays faced in emerging markets like Brazil are lingering concerns.</p> <p><b>Rig supply glut and competition.</b> Slower order flow is expected as the market takes time to absorb almost 200 rigs scheduled for delivery in the next two years, representing &gt;20% of existing fleet. Competition is intensified with the low order backlog of Korean yards and emergence of Chinese shipyards in the offshore space.</p>

Source: DBS Bank

### Key Assumptions

FY Dec	2013A	2014A	2015F	2016F	2017F
New order wins (\$\$ m)	4,193	4,192	2,800	2,500	3,000

### Segmental Breakdown

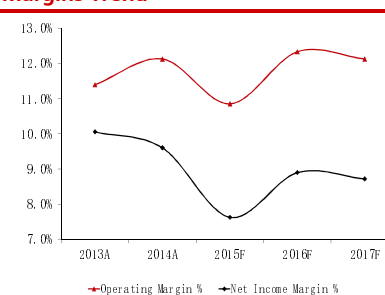
FY Dec	2013A	2014A	2015F	2016F	2017F
<b>Revenues (\$\$m)</b>					
Rig Building (newbuilds)	3,564	3,779	1,992	2,077	2,534
Offshore & Conversion	1,204	1,353	1,957	1,874	1,602
Ship repair	681	622	643	708	779
Shipbuilding (newbuilds)	0.0	0.0	0.0	0.0	0.0
Others	76.9	78.6	38.0	40.0	45.0
<b>Total</b>	<b>5,526</b>	<b>5,833</b>	<b>4,630</b>	<b>4,698</b>	<b>4,960</b>

### Income Statement (\$\$m)

FY Dec	2013A	2014A	2015F	2016F	2017F
Revenue	5,526	5,833	4,630	4,698	4,960
Cost of Goods Sold	(4,818)	(4,989)	(3,979)	(3,987)	(4,220)
<b>Gross Profit</b>	<b>708</b>	<b>844</b>	<b>651</b>	<b>711</b>	<b>740</b>
Other Opg (Exp)/Inc	(78.3)	(137)	(148)	(132)	(139)
<b>Operating Profit</b>	<b>630</b>	<b>707</b>	<b>502</b>	<b>579</b>	<b>601</b>
Other Non Opg (Exp)/Inc	1.96	1.19	0.0	0.0	0.0
Associates & JV Inc	15.6	9.86	(30.0)	15.0	24.4
Net Interest (Exp)/Inc	0.13	(11.3)	(34.5)	(72.7)	(83.0)
Exceptional Gain/(Loss)	17.8	0.10	0.0	0.0	0.0
<b>Pre-tax Profit</b>	<b>665</b>	<b>707</b>	<b>438</b>	<b>522</b>	<b>543</b>
Tax	(76.7)	(106)	(70.1)	(86.1)	(92.3)
Minority Interest	(32.5)	(41.2)	(14.7)	(17.4)	(18.0)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
<b>Net Profit</b>	<b>556</b>	<b>560</b>	<b>353</b>	<b>418</b>	<b>432</b>
Net Profit before Except.	538	560	353	418	432
EBITDA	744	829	609	755	802
<b>Growth</b>					
Revenue Gth (%)	24.7	5.6	(20.6)	1.5	5.6
EBITDA Gth (%)	6.0	11.4	(26.6)	24.0	6.3
Opg Profit Gth (%)	13.6	12.3	(29.0)	15.3	3.8
Net Profit Gth (Pre-ex) (%)	7.5	4.1	(37.0)	18.4	3.4
<b>Margins &amp; Ratio</b>					
Gross Margins (%)	12.8	14.5	14.0	15.1	14.9
Opg Profit Margin (%)	11.4	12.1	10.8	12.3	12.1
Net Profit Margin (%)	10.1	9.6	7.6	8.9	8.7
ROAE (%)	21.7	19.9	11.7	13.2	12.7
ROA (%)	8.5	7.2	4.1	4.6	4.5
ROCE (%)	15.9	13.2	7.2	7.2	7.0
Div Payout Ratio (%)	48.9	48.5	50.0	50.0	50.0
Net Interest Cover (x)	NM	62.9	14.6	8.0	7.2

Source: Company, DBS Bank

### Margins Trend



**Quarterly / Interim Income Statement (\$m)**

FY Dec	3Q2014	4Q2014	1Q2015	2Q2015	3Q2015
Revenue	1,712	1,445	1,304	1,208	1,130
Cost of Goods Sold	(1,507)	(1,170)	(1,135)	(1,009)	(1,039)
<b>Gross Profit</b>	<b>205</b>	<b>275</b>	<b>169</b>	<b>199</b>	<b>90.8</b>
Other Oper. (Exp)/Inc	(33.2)	(38.4)	(31.0)	(52.1)	(16.0)
<b>Operating Profit</b>	<b>171</b>	<b>236</b>	<b>138</b>	<b>147</b>	<b>74.8</b>
Other Non Opg (Exp)/Inc	0.26	(0.2)	0.19	0.44	(17.1)
Associates & JV Inc	3.39	(11.0)	3.87	(2.6)	(24.4)
Net Interest (Exp)/Inc	(3.2)	(7.4)	(7.1)	(8.9)	(10.6)
Exceptional Gain/(Loss)	0.01	0.03	0.12	0.11	0.0
<b>Pre-tax Profit</b>	<b>172</b>	<b>218</b>	<b>135</b>	<b>136</b>	<b>22.6</b>
Tax	(32.6)	(20.6)	(26.3)	(22.8)	8.95
Minority Interest	(7.2)	(19.4)	(3.0)	(3.9)	0.60
<b>Net Profit</b>	<b>132</b>	<b>178</b>	<b>106</b>	<b>109</b>	<b>32.1</b>
Net profit bef Except.	132	178	106	109	32.1
EBITDA	205	255	173	176	65.1

**Growth**

Revenue Gth (%)	27.7	(15.6)	(9.8)	(7.4)	(6.4)
EBITDA Gth (%)	5.7	24.2	(32.1)	1.8	(63.0)
Opg Profit Gth (%)	11.0	37.9	(41.5)	6.4	(49.1)
Net Profit Gth (Pre-ex) (%)	0.3	34.7	(40.5)	3.2	(70.6)

**Margins**

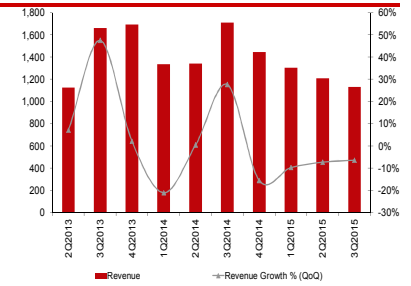
Gross Margins (%)	11.9	19.0	13.0	16.5	8.0
Opg Profit Margins (%)	10.0	16.4	10.6	12.2	6.6
Net Profit Margins (%)	7.7	12.3	8.1	9.0	2.8

**Balance Sheet (\$m)**

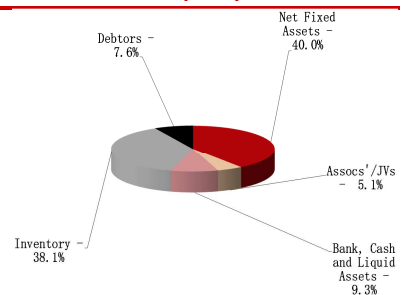
FY Dec	2013A	2014A	2015F	2016F	2017F
Net Fixed Assets	2,394	3,009	3,472	3,712	3,735
Invt in Associates & JVs	446	470	440	455	480
Other LT Assets	189	192	192	192	192
Cash & ST Invt	1,695	1,093	820	1,151	1,172
Inventory	2,084	3,005	3,307	3,356	3,543
Debtors	442	469	661	587	551
Other Current Assets	0.20	0.20	0.20	0.20	0.20
<b>Total Assets</b>	<b>7,250</b>	<b>8,238</b>	<b>8,894</b>	<b>9,453</b>	<b>9,673</b>
ST Debt	166	434	1,034	1,034	1,034
Creditor	1,781	1,826	1,543	1,566	1,240
Other Current Liab	1,583	1,189	931	958	1,010
LT Debt	600	1,308	1,808	2,058	2,308
Other LT Liabilities	310	350	350	350	350
Shareholder's Equity	2,677	2,965	3,047	3,288	3,513
Minority Interests	132	167	182	199	217
<b>Total Cap. &amp; Liab.</b>	<b>7,250</b>	<b>8,238</b>	<b>8,894</b>	<b>9,453</b>	<b>9,671</b>
Non-Cash Wkg. Capital	(838)	459	1,495	1,419	1,844
Net Cash/(Debt)	929	(648)	(2,021)	(1,941)	(2,170)
Debtors Turn (avg days)	30.1	28.5	44.5	48.5	41.9
Creditors Turn (avg days)	134.1	134.9	160.0	148.3	126.7
Inventory Turn (avg days)	147.5	190.4	299.8	317.8	311.4
Asset Turnover (x)	0.8	0.8	0.5	0.5	0.5
Current Ratio (x)	1.2	1.3	1.4	1.4	1.6
Quick Ratio (x)	0.6	0.5	0.4	0.5	0.5
Net Debt/Equity (X)	CASH	0.2	0.6	0.6	0.6
Net Debt/Equity ex MI (X)	CASH	0.2	0.7	0.6	0.6
Capex to Debt (%)	104.0	42.4	21.1	12.9	6.0
Z-Score (X)	2.3	2.2	1.8	1.8	1.9

Source: Company, DBS Bank

**Revenue Trend**



**Asset Breakdown (2015)**

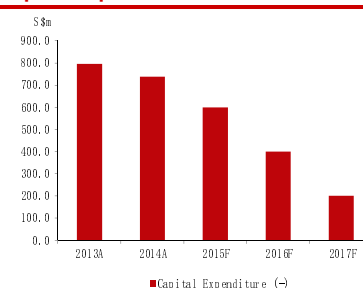


### Cash Flow Statement (\$m)

FY Dec	2013A	2014A	2015F	2016F	2017F
Pre-Tax Profit	665	707	438	522	543
Dep. & Amort.	101	115	137	161	177
Tax Paid	(53.6)	(19.5)	(121)	(70.1)	(86.1)
Assoc. & JV Inc/(loss)	(15.6)	(9.9)	30.0	(15.0)	(24.4)
Chg in Wkg.Cap.	243	(1,267)	(984)	59.9	(432)
Other Operating CF	(1.8)	(33.9)	0.0	0.0	0.0
<b>Net Operating CF</b>	<b>937</b>	<b>(508)</b>	<b>(501)</b>	<b>657</b>	<b>177</b>
Capital Exp.(net)	(797)	(738)	(600)	(400)	(200)
Other Invts.(net)	0.0	(26.5)	0.0	0.0	0.0
Invts in Assoc. & JV	(0.3)	0.0	0.0	0.0	0.0
Div from Assoc & JV	1.18	0.0	0.0	0.0	0.0
Other Investing CF	(1.5)	(5.4)	0.0	0.0	0.0
<b>Net Investing CF</b>	<b>(798)</b>	<b>(770)</b>	<b>(600)</b>	<b>(400)</b>	<b>(200)</b>
Div Paid	(283)	(285)	(272)	(177)	(209)
Chg in Gross Debt	438	964	1,100	250	250
Capital Issues	(19.8)	(10.8)	0.0	0.0	1.00
Other Financing CF	0.0	1.99	0.0	0.0	1.00
<b>Net Financing CF</b>	<b>135</b>	<b>670</b>	<b>828</b>	<b>73.5</b>	<b>42.9</b>
Currency Adjustments	11.2	(7.2)	0.0	0.0	1.00
Chg in Cash	286	(616)	(273)	330	21.1
Opg CFPS (\$ cts)	33.2	36.3	23.1	28.6	29.1
Free CFPS (\$ cts)	6.71	(59.7)	(52.7)	12.3	(1.1)

Source: Company, DBS Bank

### Capital Expenditure



### Target Price & Ratings History



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

Source: DBS Bank

DBS Bank recommendations are based on an Absolute Total Return\* Rating system, defined as follows:

**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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