

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

23 Oct 2015

HOLD

Last Traded Price: S\$2.54 (STI : 3,038.11)

Price Target : S\$2.32 (-9% downside) (Prev S\$2.48)

Reason for Report : 3Q15 results, briefing highlights

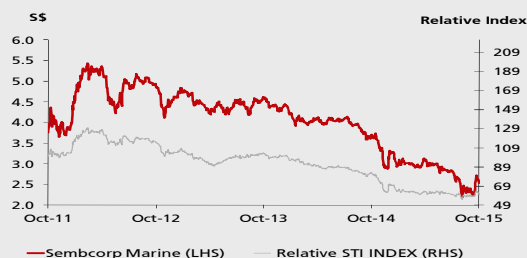
Potential Catalyst: Order wins, oil price recovery

Where we differ: earnings are more conservative than market

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)	9.5	15.0	12.7	12.3
PE Pre Ex. (X)	9.5	15.0	12.7	12.3
P/Cash Flow (X)	nm	nm	8.1	30.0
EV/EBITDA (X)	7.4	12.3	9.9	9.6
Net Div Yield (%)	5.1	3.3	3.9	4.1
P/Book Value (X)	1.8	1.7	1.6	1.5
Net Debt/Equity (X)	0.2	0.6	0.6	0.6
ROAE (%)	19.9	11.7	13.2	12.7
Earnings Rev (%)		(25)	(8)	-
Consensus EPS (S cts)		22.2	21.5	19.9
Other Broker Recs:		B: 3	S: 12	H: 10

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.

More deferments

- **3Q15 earnings were way below on profit reversals, associate losses and impairment of its stake in Cosco**
- **Rising number of deferments a worrying trend; bumpy earnings ahead**
- **Trimmed FY15/16 PATMI by 25%/8%**
- **Maintain Hold, TP lowered to S\$2.32**

3Q15 a big miss. 3Q15 net profit plunged 76% y-o-y and 71% q-o-q to a dismal S\$32m in what looks like a kitchen-sink quarter as SMM reversed profit that had been recognised for the five deferred jackup rigs for Oro Negro and Perisai. EBIT margin shrunk 5.6ppts q-o-q to 6.6%. Ship repair revenue also disappointed, falling 17% y-o-y and 21% q-o-q. In addition, there were associate losses of S\$24m (largely from Cosco) and S\$17m impairment charge for mark-to-market adjustment of its stake in Cosco Corp. These were partially mitigated by tax credits of S\$10m in the quarter. Net gearing rose from 0.5x as of end-Jun to 0.6x, a result of rising working capital needs to fund rigbuilding and capex deployed for the Tuas and Brazil yards.

Key takeaways from briefing: 1) SMM is still in discussions with Oro Negro and Perisai on the delivery of the five jackups rigs, of which two are near completion. These projects are on 20%/80% payment terms. Hence, out of prudence, SMM has reversed the profits recognised for these projects, which will be written back upon delivery. This could lead to patchy earnings in the next 1-2 years in our view; 2) Construction progress for the Brazilian drillships remains slow pending Sete Brasil's restructuring, and negotiations are still ongoing. 3) Order book inched up by S\$0.7bn to S\$11.6bn, thanks to the S\$1.4bn fixed platform contract secured in the quarter.

Maintain HOLD, TP cut to S\$2.32. We trimmed our FY15/16F earnings by 25%/8% to reflect the one-off items in 3Q, project deferments and a further 6-month delay in the commencement of the remaining three units of Petrobras drillships. While we expect near term downside from a knee-jerk reaction to SMM's share price arising from this negative earnings surprise, SMM is trading close to GFC lows of 1.5x P/Bv and supported by decent dividend yield of 4%. Maintain HOLD.

At A Glance

Issued Capital (m shrs)	2,089
Mkt. Cap (S\$m/US\$m)	5,306 / 3,806
Major Shareholders	
Sembcorp Industries Ltd (%)	61.0
Franklin Resources (%)	5.0
Free Float (%)	34.0
3m Avg. Daily Val (US\$m)	4.4

INVESTMENT THESIS

Profile	Rationale
Sembcorp Marine (SMM) is a pure play in the offshore & Marine sector. Its principal activities are rig building and offshore engineering, ship conversion, ship repair and shipbuilding of specialised vessels.	<p>Maintain HOLD; decent dividend yield. We reckon order momentum will likely lag any oil price recovery amid the rig supply glut and keen competition. Nevertheless, SMM offers decent dividend yield of 4% on the back of 50% dividend payout.</p> <p>More deferrals. Brazilian projects are likely to be 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>Slow order momentum. YTD new contract wins of S\$2.9bn 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
Our target price of S\$2.32 is based on 1.5x SMM's FY16 P/Bv, in line with GFC trough valuation.	<p>Sustained low oil price. Brent crude oil price below US\$60/bbl would defer investments into deepwater, and higher cost oilfield projects. Hence, newbuild demand for drilling rigs especially the floaters.</p> <p>Execution risks in a protected market. Cost pressures, lack of skilled labour, potential project delays faced in emerging markets like Brazil is a lingering concern.</p> <p>Rig supply glut and competition . Slower order flow is expected as the market takes time to absorb almost 200 rigs scheduled for delivery in the next two years, representing >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
Order win	4,193	4,192	2,800	2,500	3,000

Segmental Breakdown

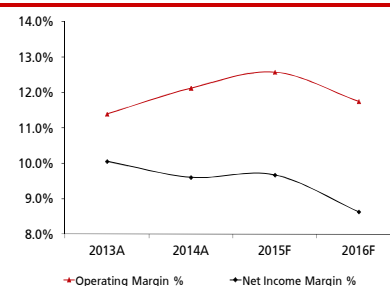
FY Dec	2013A	2014A	2015F	2016F	2017F
Revenues (\$\$m)					
Rig Building (newbuilds)	3,564	3,779	1,992	2,077	2,534
Offshore & Conversion	1,204	1,353	1,957	1,874	1,602
Ship repair	681	622	643	708	779
Shipbuilding (newbuilds)	0.0	0.0	0.0	0.0	0.0
Others	76.9	78.6	38.0	40.0	45.0
Total	5,526	5,833	4,630	4,698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

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)
Gross Profit	708	844	651	711	740
Other Opg (Exp)/Inc	(78.3)	(137)	(148)	(132)	(139)
Operating Profit	630	707	502	579	601
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
Pre-tax Profit	665	707	438	522	543
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
Net Profit	556	560	353	418	432
Net Profit before Except.	538	560	353	418	432
EBITDA	744	829	609	755	802
Growth					
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
Margins & Ratio					
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)
Gross Profit	205	275	169	199	90.8
Other Oper. (Exp)/Inc	(33.2)	(38.4)	(31.0)	(52.1)	(16.0)
Operating Profit	171	236	138	147	74.8
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
Pre-tax Profit	172	218	135	136	22.6
Tax	(32.6)	(20.6)	(26.3)	(22.8)	8.95
Minority Interest	(7.2)	(19.4)	(3.0)	(3.9)	0.60
Net Profit	132	178	106	109	0.0
Net profit bef Except.	132	178	106	109	0.0
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	(100.0)

Margins

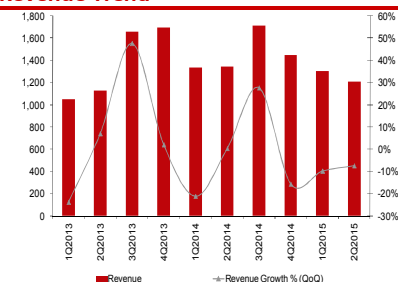
Gross Margins (%)	11.9	19.0	13.0	16.5	8.0
Opg Profit Margins (%)	10.0	16.4	10.6	12.2	6.6
Net Profit Margins (%)	7.7	12.3	8.1	9.0	0.0

Balance Sheet (\$m)

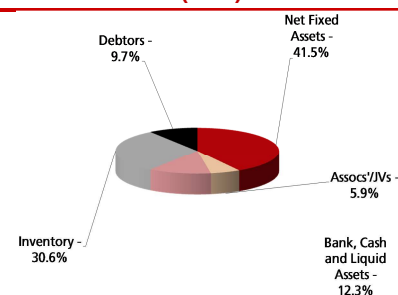
FY Dec	2013A	2014A	2015F	2016F	2017F
Net Fixed Assets	2,394	3,009	3,472	3,712	3,735
Invt in Associates & JVs	446	470	440	455	480
Other LT Assets	189	192	192	192	192
Cash & ST Invt	1,695	1,093	820	1,151	1,172
Inventory	2,084	3,005	3,307	3,356	3,543
Debtors	442	469	661	587	551
Other Current Assets	0.20	0.20	0.20	0.20	0.20
Total Assets	7,250	8,238	8,894	9,453	9,673
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
Total Cap. & Liab.	7,250	8,238	8,894	9,453	9,671
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)	2.4	2.2	2.2	2.1	2.1

Source: Company, DBS Bank

Revenue Trend



Asset Breakdown (2015)

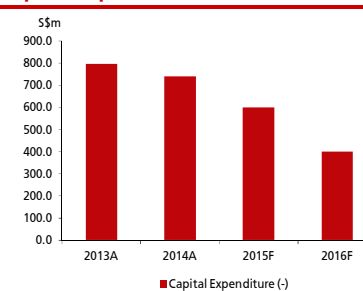


Cash Flow Statement (\$m)

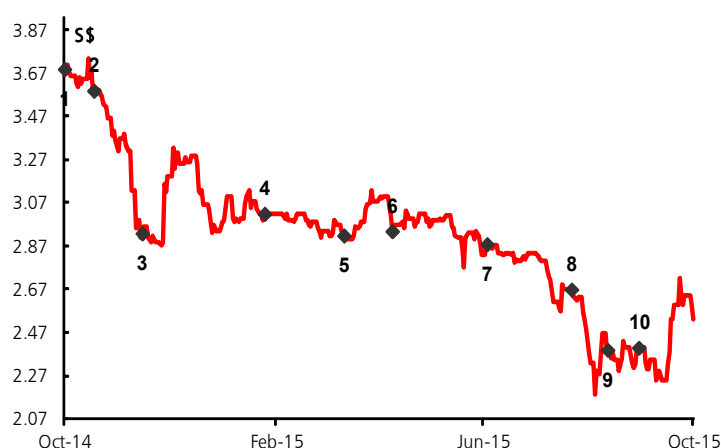
FY Dec	2013A	2014A	2015F	2016F	2017F
Pre-Tax Profit	665	707	438	522	543
Dep. & Amort.	101	115	137	161	177
Tax Paid	(53.6)	(19.5)	(121)	(70.1)	(86.1)
Assoc. & JV Inc/(loss)	(15.6)	(9.9)	30.0	(15.0)	(24.4)
Chg in Wkg.Cap.	243	(1,267)	(984)	59.9	(432)
Other Operating CF	(1.8)	(33.9)	0.0	0.0	0.0
Net Operating CF	937	(508)	(501)	657	177
Capital Exp.(net)	(797)	(738)	(600)	(400)	(200)
Other Invt.(net)	0.0	(26.5)	0.0	0.0	0.0
Invt 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
Net Investing CF	(798)	(770)	(600)	(400)	(200)
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
Net Financing CF	135	670	828	73.5	42.9
Currency Adjustments	11.2	(7.2)	0.0	0.0	1.00
Chg in Cash	286	(616)	(273)	330	21.1
Opg CFPS (S cts)	33.2	36.3	23.1	28.6	29.1
Free CFPS (S 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.

S.No.	Date	Closing Price	Target Price	Rating
1:	20 Oct 14	3.69	4.00	BUY
2:	06 Nov 14	3.59	3.80	HOLD
3:	04 Dec 14	2.93	2.89	HOLD
4:	13 Feb 15	3.02	2.89	HOLD
5:	31 Mar 15	2.92	2.89	HOLD
6:	28 Apr 15	2.94	2.89	HOLD
7:	22 Jun 15	2.88	2.89	HOLD
8:	10 Aug 15	2.67	2.55	HOLD
9:	31 Aug 15	2.39	2.48	HOLD
10:	18 Sep 15	2.40	2.48	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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