

Singapore Company Guide

Sembcorp Marine

Version 16 | Bloomberg: SMM SP | Reuters: SCMN.SI

Refer to important disclosures at the end of this report

DBS Group Research . Equity

22 Feb 2018

BUY

Last Traded Price (21 Feb 2018): S\$2.63 (STI : 3,516.23)

Price Target 12-mth: S\$2.90 (10% upside) (Prev S\$3.10)

Analyst

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What's New

- Wider-than-expected loss in 4Q17 partly due to cost overrun for several projects' variation orders
- Slashed FY18/19 forecasts by 54-58% to reflect operating loss at current activity level; earnings improvement slipping into 2H18
- Declared 1 Sct final dividend
- Potential price pullback offers healthier entry point; TP adjusted to S\$2.90

Price Relative



Forecasts and Valuation

FY Dec (\$ m)	2016A	2017A	2018F	2019F
Revenue	3,545	2,387	3,905	4,202
EBITDA	330	214	359	458
Pre-tax Profit	90.5	(15.6)	63.4	138
Net Profit	78.8	14.1	49.9	109
Net Pft (Pre Ex.)	78.8	(32.7)	49.9	109
Net Pft Gth (Pre-ex) (%)	nm	nm	nm	117.5
EPS (\$ cts)	3.77	0.67	2.39	5.20
EPS Pre Ex. (\$ cts)	3.77	(1.6)	2.39	5.20
EPS Gth Pre Ex (%)	(127)	(142)	(253)	117
Diluted EPS (\$ cts)	3.77	0.67	2.39	5.20
Net DPS (\$ cts)	2.50	2.00	2.00	2.00
BV Per Share (\$ cts)	123	119	119	122
PE (X)	69.8	390.1	110.0	50.6
PE Pre Ex. (X)	69.8	nm	110.0	50.6
P/Cash Flow (X)	9.7	110.6	10.3	11.7
EV/EBITDA (X)	25.5	38.7	22.4	17.4
Net Div Yield (%)	1.0	0.8	0.8	0.8
P/Book Value (X)	2.1	2.2	2.2	2.2
Net Debt/Equity (X)	1.1	1.1	1.0	0.9
ROAE (%)	3.1	0.6	2.0	4.3
Earnings Rev (%)			(58)	(54)
Consensus EPS (\$ cts):			4.2	6.1
Other Broker Recs:		B: 7	S: 6	H: 7

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

Look beyond weak near-term earnings

Maintain BUY; TP reduced to S\$ 2.90 after earnings revisions, still based on higher 2.4x FY18 P/BV multiple (0.5SD below mean). We continue to like SMM as a key proxy to the recovery in the O&G and O&M sectors, with strong order wins as key re-rating catalyst. Though, in the near term, we reckon that sentiment might be adversely affected by the wider-than-expected losses in 4Q17; and the M&A premium, which we estimated to be ~40 Sct. This could be given back if privatisation rumour is off the table..

Where we differ: more bullish on SMM's contract wins. Order wins, a critical leading indicator for earnings recovery, is set to rise in the next 12 months. We believe SMM's strong order pipeline would translate into S\$3bn in new orders in 2018, which could potentially include 1) a semi-submersible production unit for Shell's Vito at S\$400-800m; 2) Newbuild FPSO for Energean's Karish-Tanin project at S\$500m; 3) two large Compressed Gas Liquid carriers for SeaOne Caribbean valued at S\$800m in total; 4) a GraviFloat (SMM's proprietary technology) modularised LNG exporting terminal for Poly-GCL at c.S\$1bn.

Reactivation of Sete Brasil rig orders. The landmark deal to sell all nine terminated jackup rigs to Borr Drilling and the disposal of harsh environment semisubmersible rig West Rigel have eliminated the key overhanging concerns on SMM. The restructuring of customer Sete Brasil is also seemingly closer to a resolution, pending approval of the revised restructuring proposal submitted at end-Aug 2017. We believe Singapore rigbuilders are well-positioned to deliver at least 4-5 rigs each (which are in the advance stages of construction) out of Sete Brasil's existing 13 orders (c.S\$1bn each). The reactivation of rig construction will be another re-rating catalyst.

Valuation:

Our target price of S\$ 2.90 is based on 2.4x FY18 P/BV, pegged to 0.5SD below its mean valuation since 2004. SMM's book value has already been written down after the massive S\$609m provisions taken in FY15.

Key Risks to Our View:

Key downside risks are sustained low oil prices which would affect rig count and newbuilding activities, execution risks in new product types, and corruption allegations in Brazil that, if found guilty, could lead to financial and reputational loss. Upside risk could come from privatisation or M&A activities, as well as the write-back of provisions from successful deliveries or vessel sales.

At A Glance

Issued Capital (m shrs)	2,088
Mkt. Cap (S\$m/US\$m)	5,491 / 4,148
Major Shareholders (%)	
Sembcorp Industries Ltd	61.0
Franklin Resources	5.0
Free Float (%)	34.0
3m Avg. Daily Val (US\$m)	18.1
ICB Industry : Oil & Gas / Oil Equipment, Services & Dist	

WHAT'S NEW

4Q17 losses bigger than expected

First operating loss. With the exception of 4Q15, when earnings were hit by one-off massive provision, SMM has reported its first operating loss since 2004.

Net loss amounted to S\$33.8m for 4Q17. Stripping out forex gains (S\$20m), tax credit (S\$19m), and inventory & work-in-progress write back (S\$32m), losses would have been c.S\$100m, a substantial portion of which we believe was attributable to expected cost overrun for several projects' variation orders as customers have yet agreed to pay. We believe total cost overrun for disputed variation orders exceeded S\$100m last year.

Expect gradual improvement. We have slashed our FY18/19 forecasts by 54-58%. Taking the cue from 4Q17, SMM might continue to incur some losses in 1H18 as revenue might remain low until major projects start to kick in, which will take 1-2 quarters to start being recognised. Hopefully, some of the cost overrun for disputed variation orders in 2017 could be recouped this year and better economies of scale from higher activity should be realized towards 2H18.

Orderbook stood at S\$7.58bn, as at Dec-2017, with S\$1.1bn for Borr Drilling (largely to be recognised in 2018) and c.42% or S\$3.2bn from the drillship projects with Sete Brasil (expect reactivation from 2019). The remaining S\$3.3bn should largely be recognised in the next two years.

Higher enquiry level but competition is intense. Management has seen increasing enquiries in the production segment but has cautioned that competition for orders remains intense. Its core focus continue to be on production-related and LNG solutions.

Conducting FEED study for Seaone. SMM started FEED study for Seaone's compressed gas carrier in Oct-2017 and expects it to complete in 1H18, following which, the customer will decide on FID for the project. Hence, if FID is achieved, the actual contract award for the two gas carriers estimated at S\$800m seems likely to skew towards 4Q18 at the earliest.

Capex likely to trend upward slightly, from S\$178m in 2017. Management may proceed with phase 3 development of its Tuas Boulevard Yard in response to business needs. The expected capex should not be more than S\$500m.

Net gearing lowered to 1.1x, from 1.3x a quarter ago, largely attributable to the receipt of a US\$500m deposit from Borr Drilling.

Declared 1 Sct final dividend, bring full-year dividend payout to 2 Sct. This represents <1% yield. Given the low profitability, we expect a similar payout for the next two years.

Potential new order wins

Sembcorp Marine			
Type	Potential Customer / Project	Est.value (\$ m)	Status
Modularised LNG Exporting Terminal	Poly-GCL	1,000	Advanced talks
Compressed Gas Liquid carriers x2	SeaOne Caribbean	800	LOI
Semisub Production Unit	Shell's Vito	400-800	LOI
Newbuild FPSO	Energiean's Karish-Tanin	500	Forerunner
Modularised LNG Importing Terminal	-	200-300	-
FPSO conversion	-	200-300	-

Source: Upstream, Company, DBS Bank

Quarterly / Interim Income Statement (S\$m)

FY Dec	4Q2016	3Q2017	4Q2017	% chg yoy	% chg qoq
Revenue	830	317	655	(21.1)	106.7
Cost of Goods Sold	(795)	(304)	(703)	(11.6)	130.9
Gross Profit	34.7	12.4	(48.2)	nm	nm
Other Oper. (Exp)/Inc	32.4	9.58	4.52	(86.0)	(52.8)
Operating Profit	67.1	22.0	(43.6)	(165.1)	(298.2)
Other Non Opg (Exp)/Inc	(16.2)	(1.1)	10.4	nm	nm
Associates & JV Inc	(5.3)	(0.7)	(1.7)	68.3	142.6
Net Interest (Exp)/Inc	(24.3)	(22.0)	(19.2)	20.9	12.7
Exceptional Gain/(Loss)	0.0	0.0	0.0	-	-
Pre-tax Profit	21.3	(1.8)	(54.2)	nm	nm
Tax	9.36	3.42	19.2	105.3	461.4
Minority Interest	3.66	1.06	1.21	(67.1)	13.7
Net Profit	34.3	2.72	(33.8)	nm	nm
Net profit bef Except.	34.3	2.72	(33.8)	nm	nm
EBITDA	98.7	69.9	13.1	(86.7)	(81.3)
Margins (%)					
Gross Margins	4.2	3.9	(7.4)		
Opg Profit Margins	8.1	6.9	(6.7)		
Net Profit Margins	4.1	0.9	(5.2)		

Source of all data: Company, DBS Bank

CRITICAL DATA POINTS TO WATCH

Critical Factors

Oil price rebound and reversal in capex trend. OPEC's output cut, effective 1 January 2017, brought forward oil equilibrium to 2Q17, and led to an oil price recovery and capex increase after 2-3 years of contraction. The injection of cashflow, through oil majors' capex into the O&G ecosystem, is much needed to stimulate O&G activity.

Order-book replenishment. Order wins and order-book trends are often the key drivers of rigbuilders' share prices and earnings. Based on existing capacity, SMM requires ~\$4bn worth of order replenishments every year in an ideal case. We expect new orders to recover to \$3bn in FY18 from the dismal ~\$300m in FY16 and \$1bn in FY17, driven by the new GraviFloat modularised LNG terminal solutions. SMM's net order-book stood at \$7.58bn as at Dec-2017, with c.42% or \$3.2bn from the drillship projects with Sete Brasil and 14% or \$1.1bn for Borr Drilling. This translates into a book-to-bill ratio of over 2x based on the existing delivery schedule.

Rig utilisation and day rates bottoming out, uptick in offshore rig count since January 2017. Utilisation and day rates have fallen by around 40-50% from June 2014 levels. On a positive note, utilisation rates seem to be bottoming out. We believe a gradual recovery in oil prices and the rig market will set the stage for rising newbuild demand thereafter.

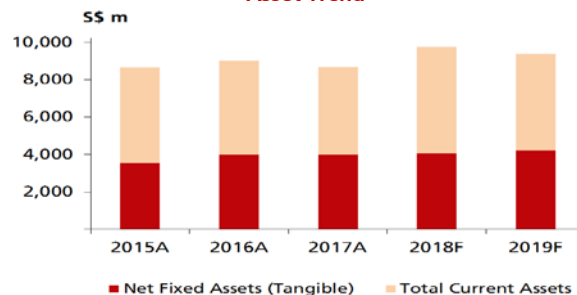
Pace of rigbuilding recovery is dependent on oil price rebound, retirement of old fleet, and cancellations at Chinese yards. Oil price rebounding above US\$60/bbl will stimulate E&P activities and thus rig demand, while rig attrition and cancellations will soothe the supply pressure and eventually bring the sector back to equilibrium.

Shipyard merger on the cards? While the macro outlook has improved, the rigbuilding sector continues to face structural issues with yard overcapacity and rig oversupply. Both Singapore rigbuilders have been rationalising their operations since early 2015 to cope with the lower activity level. A merger could make sense to further streamline their operations, achieve cost synergies and eliminate competition in the medium term.

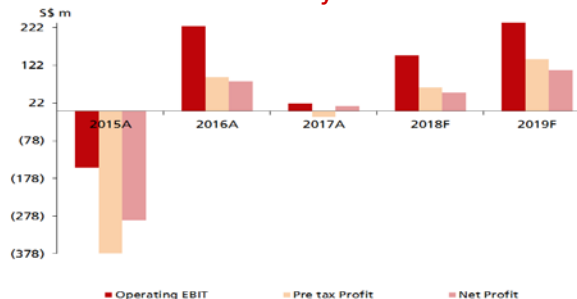
Sales Trend



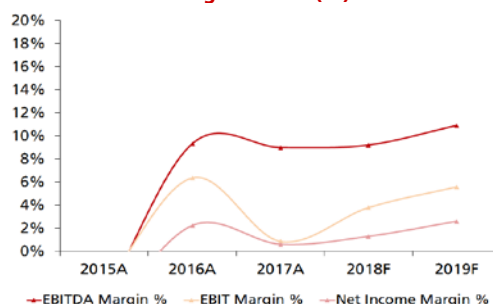
Asset Trend



Profitability Trend



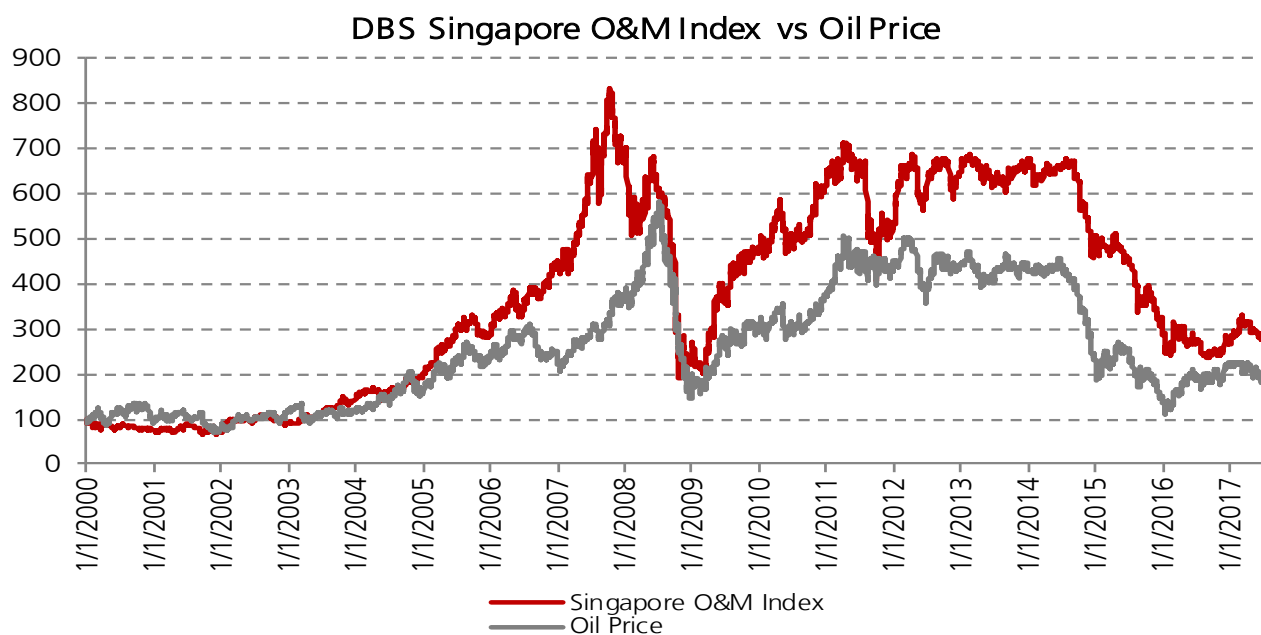
Margin Trends (%)



Source: Company, DBS Bank

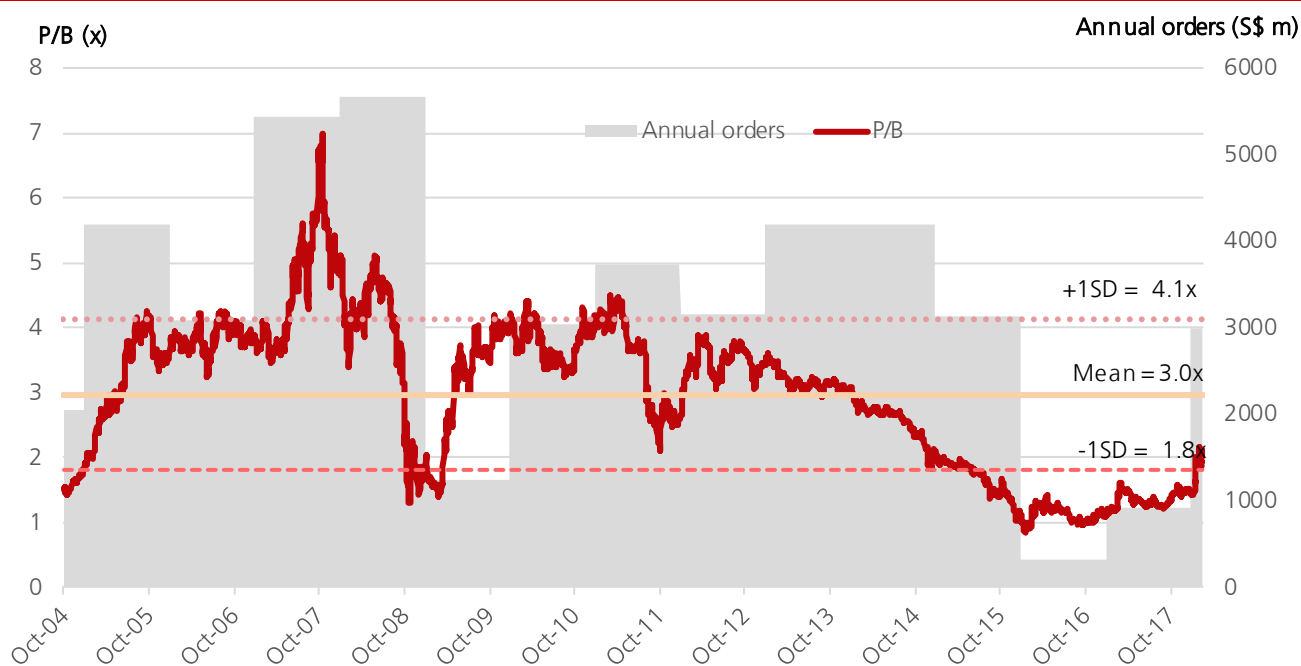
Appendix 1:

Singapore Offshore Marine vs Oil Price



Source: DBS Bank, Bloomberg Finance L.P., Company

SMM's valuation vs contract wins



Source: DBS Bank, Bloomberg Finance L.P., Company

Balance Sheet:

Net gearing reduced to 1.1x as at end-Dec 2017, from 1.3x a quarter ago following receipt of Borr's S\$500m downpayment in Oct. Gearing should decline to below 1x by 2019 with the delivery of the jackup rig and collection from Borr Drilling. In addition, the completion of the new yard in 2016 should reduce yard capex to a more normal level ~S\$100-200m for maintenance capex and up to S\$500m if the Phase 3 development of the New Integrated Yard @ Tuas is kickstarted. Otherwise, most of SMM's current projects are non-drilling solutions, which are largely on progressive payment terms, and thus have lower working capital requirements

Share Price Drivers:

Recovery in oil prices. Rising oil prices typically lift sentiment on rigbuilders. We believe SMM would benefit if oil prices recover and are sustained at least at the US\$60/bbl level, which would trigger more offshore oil & gas capex spending.

Order win momentum. Shipyards are orderbook-driven. Strong order flows could push up their share prices, as investors reward greater visibility on revenues and earnings.

Restructuring of Sete Brasil. The successful restructuring of Sete Brasil will allow the rig-owner to obtain financing for its rig-building programme. This will eliminate an overhang on the rig-builders.

Key Risks:

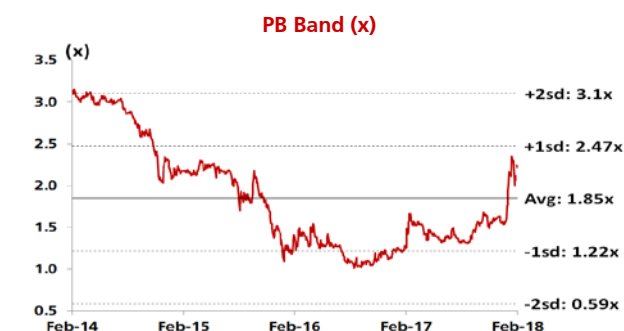
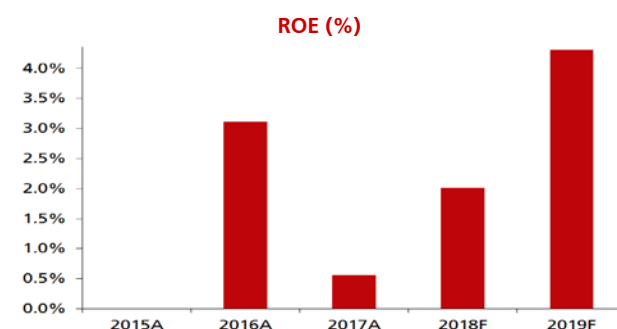
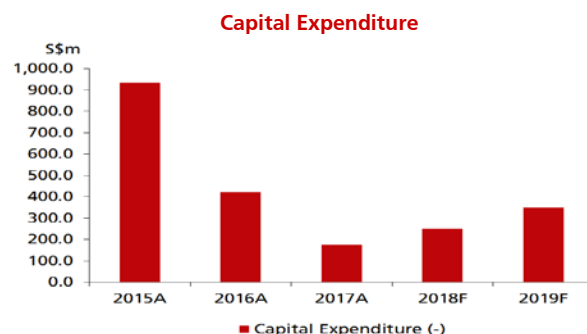
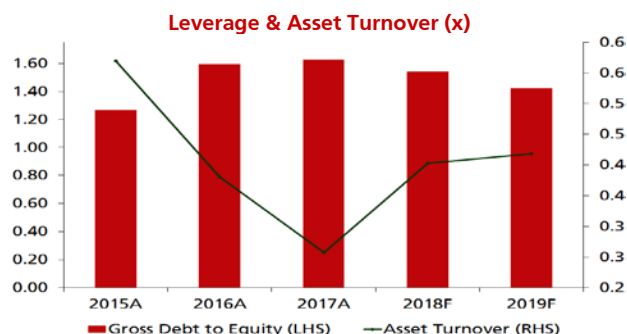
Sustained low oil price. Brent crude oil prices of below US\$60/bbl would defer investments into deepwater projects, and higher-cost oilfield projects. This could dampen newbuild demand for drilling rigs, especially floaters.

Corruption scandal in Brazil. SMM has initiated an internal investigation against the bribery allegations in Brazil in 2015. The investigation is ongoing, and it is not aware of any irregularities thus far. Meanwhile SMM's in Brazilian agent – Mr Guilherme Esteves de Jesus is defending the charges against him on paying bribes to secure the Drillship contracts and court hearing of the charges is not yet known. The risks of potential financial and reputational loss remain an overhang.

Rig supply glut and competition. A slower order flow is expected, as the market takes time to absorb about 150 rigs scheduled for delivery in the next two years, representing c.20% of its existing fleet. Competition has intensified with the low order backlog of Korean yards and emergence of Chinese shipyards in the offshore space.

Company Background

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 building of specialised vessels.



Source: Company, DBS Bank

Key Assumptions

FY Dec	2015A	2016A	2017A	2018F	2019F
New order wins (\$\$ m)	3,128	320	931	3,000	3,000

Segmental Breakdown

FY Dec	2015A	2016A	2017A	2018F	2019F
Revenues (\$\$m)					
Rigs & Floaters	3,319	1,887	1,098	2,673	2,880
Offshore Platforms	1,017	1,116	732	657	709
Repairs & Upgrades	557	460	471	495	533
Specialised Shipbuilding	0.0	0.0	0.0	0.0	0.0
Others	75.8	82.1	86.0	80.0	80.0
Total	4,968	3,545	2,387	3,905	4,202

Income Statement (\$\$m)

FY Dec	2015A	2016A	2017A	2018F	2019F
Revenue	4,968	3,545	2,387	3,905	4,202
Cost of Goods Sold	(4,837)	(3,252)	(2,327)	(3,694)	(3,891)
Gross Profit	131	293	60.5	210	310
Other Opng (Exp)/Inc	(281)	(67.4)	(40.1)	(62.5)	(75.6)
Operating Profit	(150)	225	20.5	148	235
Other Non Opg (Exp)/Inc	(18.2)	(18.9)	4.69	0.0	0.0
Associates & JV Inc	(173)	(35.1)	(3.6)	5.00	7.00
Net Interest (Exp)/Inc	(36.0)	(80.7)	(84.0)	(89.5)	(104)
Exceptional Gain/(Loss)	0.0	0.0	46.8	0.0	0.0
Pre-tax Profit	(378)	90.5	(15.6)	63.4	138
Tax	77.6	(15.4)	25.6	(11.4)	(24.8)
Minority Interest	10.3	3.62	4.13	(2.1)	(4.5)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	(290)	78.8	14.1	49.9	109
Net Profit before Except.	(290)	78.8	(32.7)	49.9	109
EBITDA	(210)	330	214	359	458
Growth					
Revenue Gth (%)	(14.8)	(28.6)	(32.7)	63.6	7.6
EBITDA Gth (%)	nm	nm	(35.1)	67.5	27.5
Opg Profit Gth (%)	(121.2)	(250.2)	(90.9)	623.2	58.5
Net Profit Gth (Pre-ex) (%)	nm	nm	nm	nm	117.5
Margins & Ratio					
Gross Margins (%)	2.6	8.3	2.5	5.4	7.4
Opg Profit Margin (%)	(3.0)	6.4	0.9	3.8	5.6
Net Profit Margin (%)	(5.8)	2.2	0.6	1.3	2.6
ROAE (%)	(10.6)	3.1	0.6	2.0	4.3
ROA (%)	(3.3)	0.8	0.2	0.5	1.1
ROCE (%)	(2.6)	2.8	0.3	1.8	2.9
Div Payout Ratio (%)	N/A	66.3	296.7	83.6	38.5
Net Interest Cover (x)	(4.2)	2.8	0.2	1.7	2.3

Source: Company, DBS Bank

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

FY Dec	4Q2016	1Q2017	2Q2017	3Q2017	4Q2017
Revenue	830	760	655	317	655
Cost of Goods Sold	(795)	(740)	(579)	(304)	(703)
Gross Profit	34.7	19.9	76.3	12.4	(48.2)
Other Oper. (Exp)/Inc	32.4	(6.4)	(47.8)	9.58	4.52
Operating Profit	67.1	13.6	28.5	22.0	(43.6)
Other Non Opg (Exp)/Inc	(16.2)	0.02	(4.6)	(1.1)	10.4
Associates & JV Inc	(5.3)	(0.7)	(0.5)	(0.7)	(1.7)
Net Interest (Exp)/Inc	(24.3)	(22.9)	(19.8)	(22.0)	(19.2)
Exceptional Gain/(Loss)	0.0	46.8	0.0	0.0	0.0
Pre-tax Profit	21.3	36.8	3.52	(1.8)	(54.2)
Tax	9.36	2.77	0.19	3.42	19.2
Minority Interest	3.66	0.0	1.89	1.06	1.21
Net Profit	34.3	39.5	5.59	2.72	(33.8)
Net profit bef Except.	34.3	(7.3)	5.59	2.72	(33.8)
EBITDA	98.7	59.9	71.6	69.9	13.1

Growth

Revenue Gth (%)	(6.5)	(8.4)	(13.8)	(51.7)	106.7
EBITDA Gth (%)	168.5	(39.4)	19.6	(2.3)	(81.3)
Opg Profit Gth (%)	103.7	(79.7)	109.7	(22.7)	(298.2)
Net Profit Gth (Pre-ex) (%)	(257.4)	(121.2)	(177.1)	(51.4)	(1,343.7)

Margins

Gross Margins (%)	4.2	2.6	11.6	3.9	(7.4)
Opg Profit Margins (%)	8.1	1.8	4.3	6.9	(6.7)
Net Profit Margins (%)	4.1	5.2	0.9	0.9	(5.2)

Balance Sheet (\$\$m)

FY Dec	2015A	2016A	2017A	2018F	2019F
Net Fixed Assets	3,541	3,987	3,995	4,062	4,218
Invt in Associates & JVs	312	74.8	68.0	73.0	80.0
Other LT Assets	231	335	400	400	400
Cash & ST Invt	690	1,269	1,335	1,376	1,252
Inventory	3,833	3,067	2,776	3,004	2,626
Debtors	590	492	567	1,302	1,273
Other Current Assets	3.89	191	11.2	11.2	11.2
Total Assets	9,201	9,415	9,151	10,227	9,861
ST Debt	915	1,364	853	853	853
Creditor	2,519	2,120	2,061	3,254	3,001
Other Current Liab	463	264	228	301	317
LT Debt	2,465	2,791	3,247	3,047	2,847
Other LT Liabilities	175	268	242	242	242
Shareholder's Equity	2,511	2,562	2,478	2,486	2,553
Minority Interests	153	45.6	41.2	43.3	47.8
Total Cap. & Liab.	9,201	9,415	9,151	10,227	9,861
Non-Cash Wkg. Capital	1,445	1,365	1,064	762	593
Net Cash/(Debt)	(2,690)	(2,886)	(2,766)	(2,524)	(2,448)
Debtors Turn (avg days)	38.9	55.7	80.9	87.3	111.8
Creditors Turn (avg days)	168.5	273.7	357.6	278.1	310.6
Inventory Turn (avg days)	265.2	407.1	499.7	302.4	279.6
Asset Turnover (x)	0.6	0.4	0.3	0.4	0.4
Current Ratio (x)	1.3	1.3	1.5	1.3	1.2
Quick Ratio (x)	0.3	0.5	0.6	0.6	0.6
Net Debt/Equity (X)	1.0	1.1	1.1	1.0	0.9
Net Debt/Equity ex MI (X)	1.1	1.1	1.1	1.0	1.0
Capex to Debt (%)	27.6	10.1	4.3	6.4	9.5
Z-Score (X)	1.2	1.2	1.1	1.2	1.3

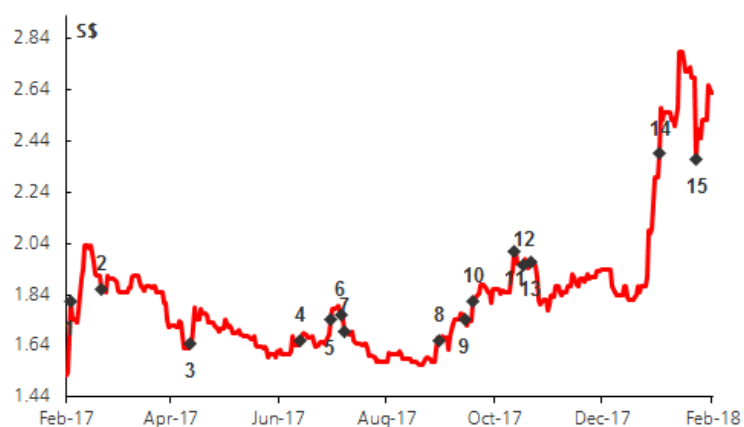
Source: Company, DBS Bank

Cash Flow Statement (\$m)

FY Dec	2015A	2016A	2017A	2018F	2019F
Pre-Tax Profit	(378)	90.5	(15.6)	63.4	138
Dep. & Amort.	132	159	193	183	193
Tax Paid	(104)	(28.0)	(12.6)	(24.9)	(11.4)
Assoc. & JV Inc/(loss)	173	35.1	3.62	(5.0)	(7.0)
Chg in Wkg.Cap.	(291)	284	(59.3)	316	156
Other Operating CF	(521)	27.5	(59.3)	0.0	0.0
Net Operating CF	(989)	569	49.6	533	468
Capital Exp.(net)	(932)	(421)	(176)	(250)	(350)
Other Invt.(net)	0.0	0.0	206	0.0	0.0
Invt in Assoc. & JV	0.0	(3.3)	0.0	0.0	0.0
Div from Assoc & JV	0.0	0.0	0.0	0.0	0.0
Other Investing CF	0.0	(65.9)	36.1	0.0	0.0
Net Investing CF	(932)	(490)	65.4	(250)	(350)
Div Paid	(265)	(73.7)	(41.8)	(41.8)	(41.8)
Chg in Gross Debt	1,744	768	24.8	(200)	(200)
Capital Issues	(11.3)	(3.0)	0.0	0.0	0.0
Other Financing CF	2.02	(157)	(6.7)	0.0	0.0
Net Financing CF	1,469	534	(23.8)	(242)	(242)
Currency Adjustments	4.71	(22.7)	(7.3)	0.0	0.0
Chg in Cash	(447)	590	84.0	41.1	(123)
Opg CFPS (\$ cts)	(33.4)	13.6	5.22	10.4	15.0
Free CFPS (\$ cts)	(92.0)	7.05	(6.1)	13.5	5.67

Source: Company, DBS Bank

Target Price & Ratings History



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

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	23 Feb 17	1.82	1.78	BUY
2:	13 Mar 17	1.86	1.78	BUY
3:	02 May 17	1.65	1.78	BUY
4:	03 Jul 17	1.66	1.78	BUY
5:	20 Jul 17	1.74	2.30	BUY
6:	26 Jul 17	1.76	2.30	BUY
7:	28 Jul 17	1.70	2.30	BUY
8:	20 Sep 17	1.66	2.30	BUY
9:	04 Oct 17	1.75	2.30	BUY
10:	09 Oct 17	1.82	2.30	BUY
11:	01 Nov 17	2.01	2.30	BUY
12:	06 Nov 17	1.96	2.30	BUY
13:	10 Nov 17	1.97	2.30	BUY
14:	22 Jan 18	2.39	3.10	BUY
15:	12 Feb 18	2.37	3.10	BUY

Source: DBS Bank

Analyst: Pei Hwa HO

DBS Bank recommendations are based on 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

Completed Date: 22 Feb 2018 09:08:44 (SGT)

Dissemination Date: 22 Feb 2018 09:25:18 (SGT)

Sources for all charts and tables are DBS Bank unless otherwise specified.

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