Offshore & Marine Sector
Results season takeaways

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Phillip Securities Research Pte Ltd

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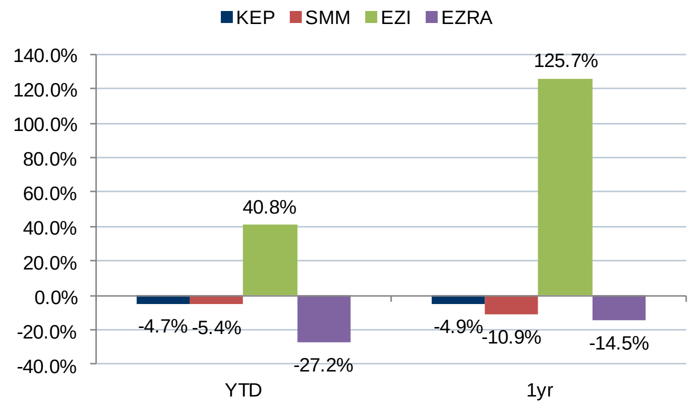
Sector Overview
The Offshore & Marine (O&M) Sector under our coverage consists of Keppel Corp, Sembcorp Marine, Ezion Holdings and Ezra Holdings. Keppel Corp is a conglomerate that also has property and infrastructure divisions whilst Sembcorp Marine, Ezion and Ezra are pure plays to the O&M sector.

- Mixed bag of results in 2Q13
- O&M fundamentals still strong
- We continue to like both Keppel Corp and Ezion

Earnings surprise?
There was a mixed bag of results in the second quarter. Keppel Corp's results were mostly in-line; earnings were down yoy mainly due to drop in revenue recognition from sales of Reflections @ Keppel Bay and lower volume of work in its O&M segment, partially offset by growth in Infrastructure and solid O&M margins. Sembcorp Marine's results were slightly below expectations due to conservative recognition for new design rigs and lower revenue recognition. Ezion's results were solid driven by new projects contributions and steady margin. Ezra's results were disappointing as its Subsea segment continues to be a drag due to delays in project execution and additional unexpected costs recognition for certain projects.

Fig 1: Total return for the sector



Source: Bloomberg, Phillip Securities Research

Top pick: Keppel Corp
Albeit the fundamentals for the O&M sector remains strong, management from both Keppel Corp and Sembcorp Marine see competition from the Chinese and Korean yards may put pressure on margins. We continue to like Keppel Corp for its stronger operating performance, better execution and attractive dividend yield of 4.6%. Ezion is also a strong performer within the small/mid cap space, with good business model and high earnings growth visibility, via its SEU fleet expansion with firm contracts already secured.

Offshore & Marine Sector

Company	Rating	Price (S$)	TP (S$)	Upside (%)	M.Cap. (SG$'mn)
Rig builder					
Keppel Corp	Accumulate	10.21	12.25	20.0%	18,454
Sembcorp Marine	Neutral	4.35	4.42	1.6%	9,090
Small/mid cap					
Ezion Holdings	Accumulate	2.38	2.71	13.9%	2,294
Ezra Holdings	Neutral	0.83	1.00	20.5%	812

Source: Bloomberg, Phillip Securities Research

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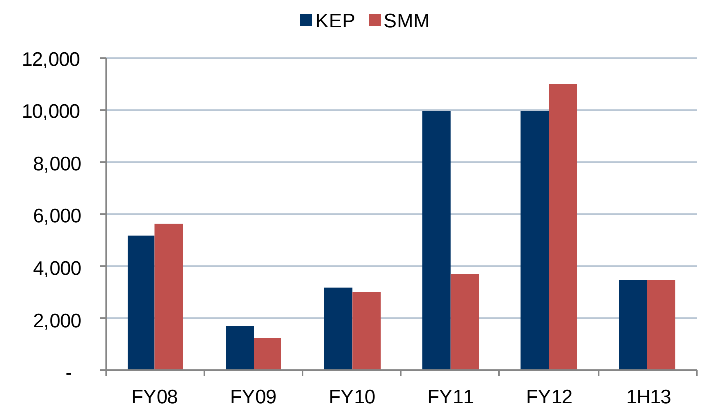
Rig-builders

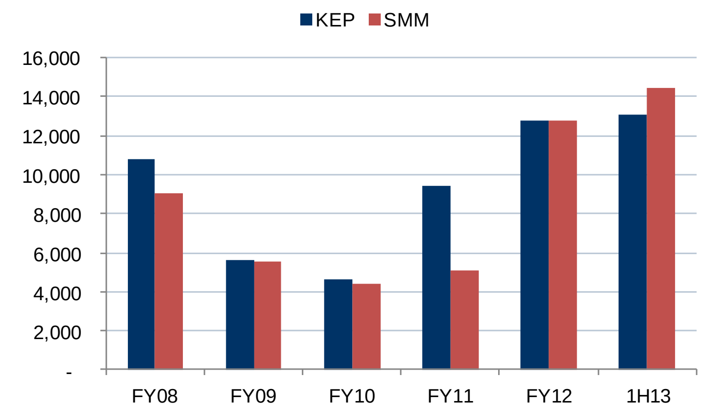
1H13 has remained a strong quarter in terms of order wins for rig builders. Keppel Corp bagged S$3.5bn worth of contracts, which included a S$1bn contract from SOCAR for a semi-sub rig based on its proprietary KFELS DSS 38M design, customized for the Caspian Sea's harsh environment condition. The group has a net order book of S$13.1bn, with visibility until 2019. Similarly, Sembcorp Marine fared well with total new orders of S$3.5bn, including S$750mn worth of contract for an ultra-high spec jack-up rig based on the proven Gusto MSC CJ70 design for Noble. The group's net order book is at a new record high of S$14.4bn.

Fig 2: New order wins (S$mn)



Source: Companies, Phillip Securities Research

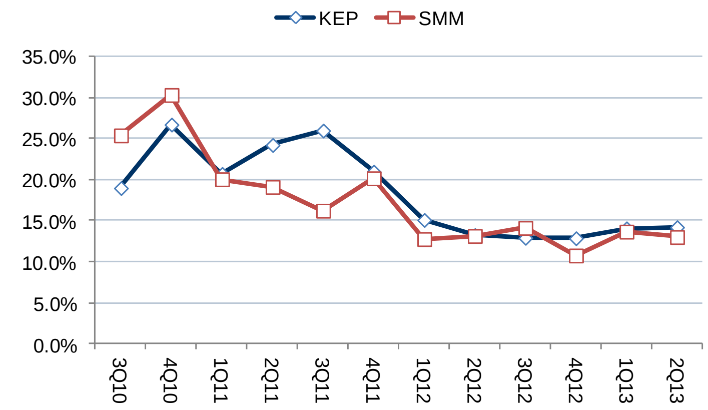
Fig 3: Net order books (S$mn)



Source: Companies, Phillip Securities Research

In terms of operational performance, Keppel Corp's O&M margin remains solid at 14.2% in 2Q13 (vs. 14.1% in 1Q13). We believe this is mainly due to the rise in rig deliveries from 5 units in 1Q13 to 6 units in 2Q13. On the other hand, Sembcorp Marine's operating margin eased slightly from 13.7% in 1Q13 to 13.0% in 2Q13, supported by a gain from disposal of PPE of S$13.7mn. Excluding the one-off gain, we estimate underlying operating margin to be about 12%. We believe Sembcorp Marine's margins will continue to be under pressure going forward as it starts recognition for the 2nd Brazilian drillship and new design well intervention semi-sub rigs, which will yield lower initial margins.

Fig 4: Quarterly operating margins for rig builders

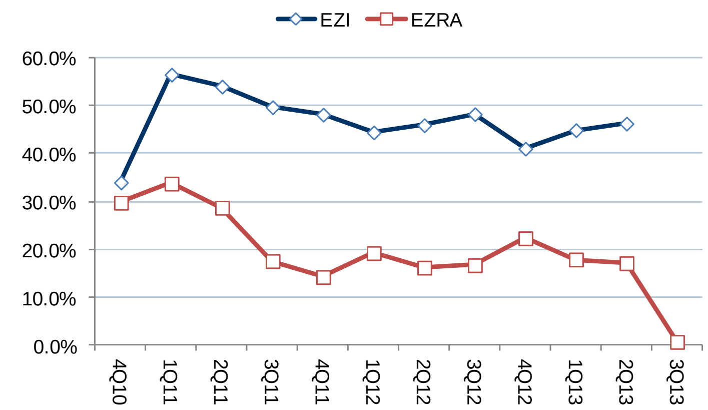


Source: Companies, Phillip Securities Research

Small/Mid Caps

In the small/mid cap space, we are seeing mixed performance as well. Ezion's gross margin remains steady at 46.3% in 2Q13 vs. 45.9% in 2Q12, this is also slightly higher than 1Q13's 44.9%. In contrast, Ezra's gross margin dropped sharply to 0.7% in 3Q13 from 16.7% in 3Q12, no thanks to its Subsea segment due to delays in project execution and additional unexpected costs recognition for certain projects. We expect downward pressure on Ezra's margins for the next few quarters as it may still take some time for its Subsea segment to fully integrate the AMC business.

Fig 5: Quarterly gross margins for small/mid caps

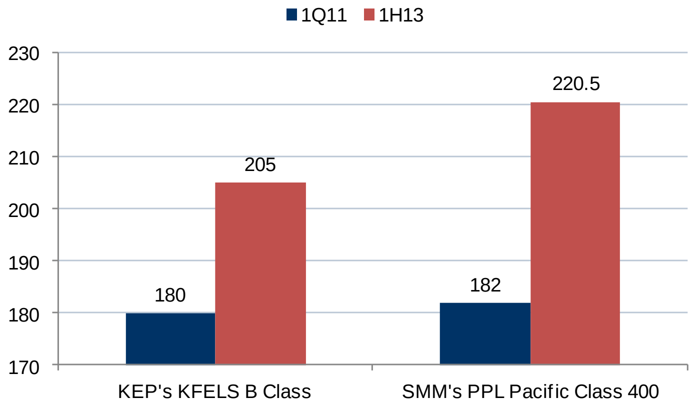


Source: Companies, Phillip Securities Research
* Note that Ezra financial year-end is in Aug

Top pick: Keppel Corp

Albeit the fundamentals for the O&M sector remains strong, management from both Keppel Corp and Sembcorp Marine see competition from the Chinese and Korean yards is beginning to intensify and may put pressure on margins. That said, we think that downside risks to Singapore yards are limited in the near and medium term, due to better pricing secured. Indeed, Singapore yards have managed to raise pricing by about 14%-21% for their proprietary designs over the past 2 years, even though their Chinese peers have aggressively entered the offshore market with lower pricing and attractive payment terms.

Fig 6: Pricing of jack-up rigs from SG yards (US$mn)



Source: Companies, Phillip Securities Research

We continue to like Keppel Corp (Accumulate, TP: S$12.25) for its stronger operating performance, better execution for its Brazilian projects and attractive dividend yield of 4.6%. Ezion (Accumulate, TP: S$2.71) is also a strong performer within the small/mid cap space, with good business model and high earnings growth visibility, via its SEU fleet expansion with firm contracts already secured.

Albeit Sembcorp Marine's (Neutral, TP: S$4.42) order book spike of 150% last year will see higher revenue growth over the next few years, we continue to see downward pressure for its margin due to recognition for new design rigs, which tend to be conservative at the initial stage, and higher costs on its new yards in Singapore and Brazil. Ezra (Neutral, TP: S$1.00) faces challenging Subsea execution issues which may continue to be a drag on margins for the next few quarters.

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Fig 7: Singapore offshore & marine sector valuation table

	Rating	FYE	Price (S$)	TP (S$)	Upside (%)	Market Cap. (SG$mn)	Equity Multiple (x) Net Income 13E	Net Income 14E	Book Value 13E	Book Value 14E	Dividend Yield (%) 13E	Dividend Yield (%) 14E
Rig builder												
Keppel Corp	Accumulate	Dec	10.21	12.25	20.0%	18,454	12.0	10.4	1.9	1.8	4.6%	4.8%
Sembcorp Marine	Neutral	Dec	4.35	4.42	1.6%	9,090	16.8	13.7	3.4	3.0	3.2%	3.4%
Small/mid cap												
Ezion Holdings	Accumulate	Dec	2.38	2.71	13.9%	2,294	15.5	9.0	2.4	1.8	0.1%	0.1%
Ezra Holdings	Neutral	Aug	0.83	1	20.5%	812	32.2	10.7	0.6	0.5	0.0%	0.0%

Source: Bloomberg, Phillip Securities Research

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