

Offshore & Marine Sector

Results season takeaways

Report type: Season Update

Sector Overview

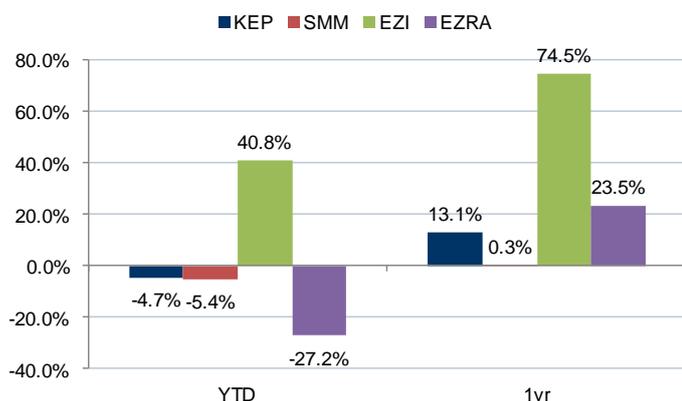
The Offshore & Marine (O&M) Sector under our coverage consists of Keppel Corp, Sembcorp Marine, Ezion Holdings and Ezra Holdings. Keppel Corp is a conglomerate that also has property and infrastructure divisions whilst Sembcorp Marine, Ezion and Ezra are pure plays to the O&M sector.

- More positives than negatives in 3Q
- O&M fundamentals remain sound
- Keppel Corp and Ezion remain our favorite

Earnings surprise?

The recent quarterly result season ended with more positives than negatives. Keppel Corp reported solid results; despite lower revenue, earnings were up YoY mainly on positive O&M margin surprise, improvement in China property sales and higher profit of power and gas business. Sembcorp Marine delivered weak results due to lower-than-expected margins, which was partially offset by higher revenue. Ezion announced steady earnings driven by more SEUs deployment and higher offshore logistics contribution from Australia's LNG projects. Ezra's core earnings swing back into the black as Subsea margins recovered from its decision to 'kitchen-sink' earnings in the previous quarter.

Fig 1: Total return for the sector



Source: Bloomberg, Phillip Securities Research

Top pick: Keppel Corp

Management from both Keppel Corp and Sembcorp Marine reiterate the O&M sector prospects remain robust underpinned by exploration activities with increasing interests in harsh environment and field development programs. Keppel Corp remains our top pick within the O&M sector, for its (1) resilient operating performance, (2) stronger execution for its Brazilian projects, and (3) attractive dividend yield of > 4%. We also like Ezion for its (1) good business model, (2) high earnings growth visibility, and (3) undemanding valuation of < 10.0x FY14E P/E.

Offshore & Marine Sector

Company	Rating	Price (\$)	TP (\$)	Upside (%)	M.Cap. (SG\$mn)
Rig builder					
Keppel Corp	Accumulate	11.31	12.07	6.7%	20,408
Sembcorp Marine	Neutral	4.44	4.33	-2.5%	9,237
Small/mid cap					
Ezion Holdings	Accumulate	2.1	2.53	20.5%	2,427
Ezra Holdings	Neutral	1.315	1.18	-10.3%	1,287

Source: Bloomberg, Phillip Securities Research

Analyst

Nicholas Ong

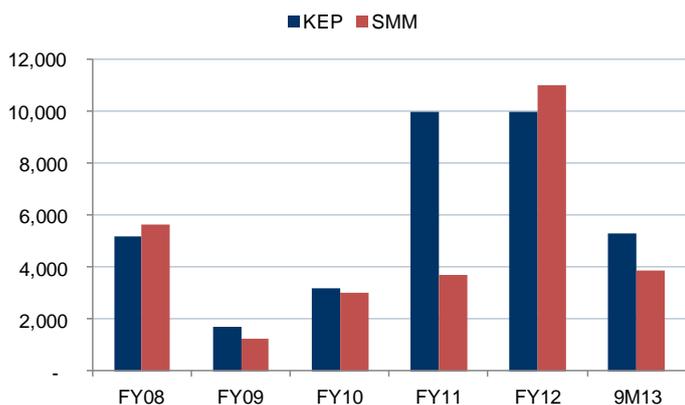
nicholasonghg@phillip.com.sg

+65 6531 5440

Rig-builders

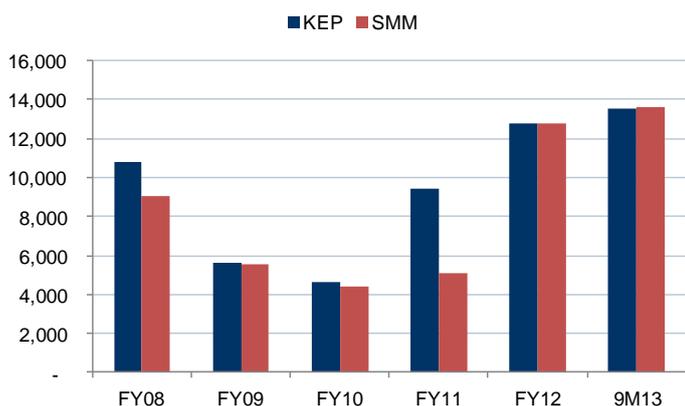
It has been a robust 9M13 in terms of order wins for Keppel Corp, as it bagged S\$5.3bn worth of contracts which included 13 jack-up rig orders, which are all based on its proprietary KFELS B Class series design. Note that we have not taken account of the 5 KFELS Super B Class jack-up rigs order win of US\$1.1bn from Transocean, which was recently secured in November. Sembcorp Marine also did fairly well, securing new order wins worth S\$3.9bn, inclusive of 7 jack-up rig orders. Keppel's S\$13.5bn robust order book and Sembcorp Marine's S\$13.6bn order backlog will provide long-term earnings visibility for both companies.

Fig 2: New order wins (\$mn)



Source: Companies, Phillip Securities Research

Fig 3: Net order books (\$mn)



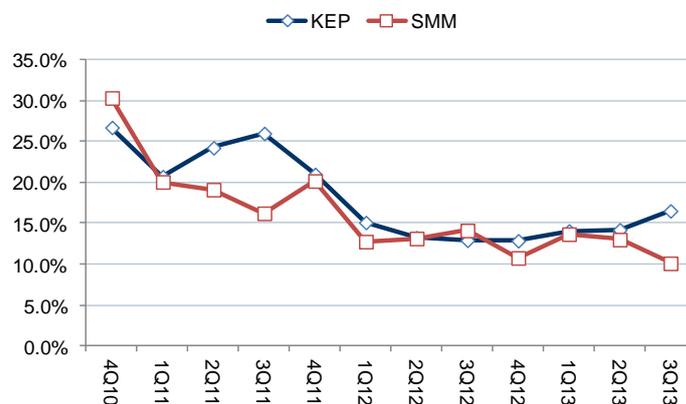
Source: Companies, Phillip Securities Research

In terms of operational performance, we see positive surprise on Keppel Corp's O&M margin, rising from 14.2% in 2Q13 to 16.5% in 3Q13, beating our expectation of ~14-15%. Management highlighted that this is mainly attributed from the delivery of 5 KFELS B Class jack-up rigs (which resulted in higher productivity and efficiency), as well as repair jobs (which typically yield higher margins). We continue to expect resilient O&M margins at 14-15% for 4Q13, as there will be another 4 jack-up rigs slated to be delivered by end of 2013.

Sembcorp Marine's margin, on the other hand, was disappointing; declining from 13.0% in 2Q13 to 10.1% in 3Q13 on conservative recognition of new design rigs (which

includes harsh environment and well intervention semi-subs). We believe margins will remain under downward pressure for the next 2 quarters, as its 2nd Brazilian drillship is expected to attain revenue recognition in 4Q13/1Q14.

Fig 4: Quarterly operating margins for rig builders



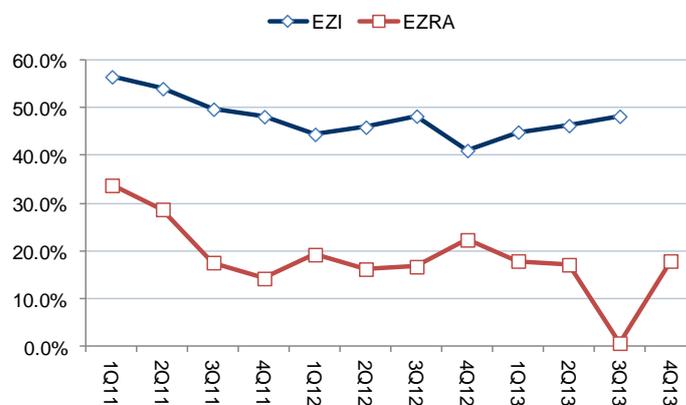
Source: Companies, Phillip Securities Research

Small/Mid Caps

Over at the O&M small/mid cap space, Ezion delivered steady results driven by more SEUs deployment and higher offshore logistics contribution from Australia's LNG projects. We expect earnings momentum to continue into FY14E, given that 14 out of 29 SEU contracts have yet to contribute; these 14 SEUs will gradually kick in from 4Q13 (3 in 4Q13, 4 in 1H14, 3 in 2H14, and 4 in FY15).

Ezra's core earnings swing back into the black, as Subsea margins recovered from its decision to 'kitchen-sink' earnings in the previous quarter. This results in 4Q13 gross margin to improve significantly to 17.9%, from 1.1% in 3Q13. That said, we remain cautious as we believe Ezra will need to show a series of good results to kick start a sustainable upward rerating of the stock.

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

Management from both Keppel Corp and Sembcorp Marine reiterate the O&M sector prospects remain robust underpinned by exploration activities with increasing interests in harsh environment and field development programs. Despite fierce competition coming from the Chinese yards, we believe established drillers/operators still prefer established yards (like KEP and SMM) for their established rig designs, strong track record, and ability to deliver on-time. This can be seen in Keppel Corp's recent US\$1.1bn contract win from Transocean for the construction of 5 KFELS Super B Class jack-up rigs, with options for an additional 5 similar rigs.

Keppel Corp (Accumulate, TP: S\$12.07) remains our top pick within the O&M sector, for its (1) resilient operating performance, (2) stronger execution for its Brazilian projects, and (3) attractive dividend yield of > 4%. We also like Ezion (Accumulate, TP: S\$2.53) for its (1) good business model (ROE > 30%), (2) high earnings growth visibility (via its SEU fleet expansion with secured contracts), and (3) undemanding valuation of < 10.0x FY14E P/E.

We remain cautious with Sembcorp Marine's (Neutral, TP: S\$4.33) operating margins, as we believe its execution of new design rigs (such as drillship, well intervention semi subs) would continue to exert downward pressure on its margins in the near-term. Albeit Ezra's (Neutral, TP: S\$1.18) Subsea division turns around from losses in the previous quarter, we believe Ezra will need to show a series of good results in order to kick start a sustainable upward rerating of the stock.

Fig 7: Singapore offshore & marine sector valuation table

	Rating	FYE	Price (S\$)	TP (S\$)	Upside (%)	Market Cap. (SG\$mn)	Equity Multiple (x)					
							Net Income		Book Value		Dividend Yield (%)	
						13E	14E	13E	14E	13E	14E	
<u>Rig builder</u>												
Keppel Corp	Accumulate	Dec	11.31	12.07	6.7%	20,408	13.4	12.5	2.1	2.0	4.2%	4.3%
Sembcorp Marine	Neutral	Dec	4.44	4.33	-2.5%	9,237	17.7	14.3	3.5	3.1	3.2%	3.4%
<u>Small/mid cap</u>												
Ezion Holdings	Accumulate	Dec	2.10	2.53	20.5%	2,427	13.4	9.3	2.5	1.9	0.0%	0.0%
Ezra Holdings	Neutral	Aug	1.315	1.18	-10.3%	1,287	25.7	14.2	0.9	1.1	0.0%	0.0%

Source: Bloomberg, Phillip Securities Research

Important Information

This publication is prepared by Phillip Securities Research Pte Ltd., 250 North Bridge Road, #06-00, Raffles City Tower, Singapore 179101 (Registration Number: 198803136N), which is regulated by the Monetary Authority of Singapore ("Phillip Securities Research"). By receiving or reading this publication, you agree to be bound by the terms and limitations set out below.

This publication has been provided to you for personal use only and shall not be reproduced, distributed or published by you in whole or in part, for any purpose. If you have received this document by mistake, please delete or destroy it, and notify the sender immediately. Phillip Securities Research shall not be liable for any direct or consequential loss arising from any use of material contained in this publication.

The information contained in this publication has been obtained from public sources, which Phillip Securities Research has no reason to believe are unreliable and any analysis, forecasts, projections, expectations and opinions (collectively, the "Research") contained in this publication are based on such information and are expressions of belief of the individual author or the indicated source (as applicable) only. Phillip Securities Research has not verified this information and no representation or warranty, express or implied, is made that such information or Research is accurate, complete, appropriate or verified or should be relied upon as such. Any such information or Research contained in this publication is subject to change, and Phillip Securities Research shall not have any responsibility to maintain or update the information or Research made available or to supply any corrections, updates or releases in connection therewith. In no event will Phillip Securities Research or persons associated with or connected to Phillip Securities Research, including but not limited to its officers, directors, employees or persons involved in the preparation or issuance of this report, (i) be liable in any manner whatsoever for any consequences (including but not limited to any special, direct, indirect, incidental or consequential losses, loss of profits and damages) of any reliance or usage of this publication or (ii) accept any legal responsibility from any person who receives this publication, even if it has been advised of the possibility of such damages. You must make the final investment decision and accept all responsibility for your investment decision, including, but not limited to your reliance on the information, data and/or other materials presented in this publication.

Any opinions, forecasts, assumptions, estimates, valuations and prices contained in this material are as of the date indicated and are subject to change at any time without prior notice.

Past performance of any product referred to in this publication is not indicative of future results.

This report does not constitute, and should not be used as a substitute for, tax, legal or investment advice. This publication should not be relied upon exclusively or as authoritative, without further being subject to the recipient's own independent verification and exercise of judgment. The fact that this publication has been made available constitutes neither a recommendation to enter into a particular transaction, nor a representation that any product described in this material is suitable or appropriate for the recipient. Recipients should be aware that many of the products, which may be described in this publication involve significant risks and may not be suitable for all investors, and that any decision to enter into transactions involving such products should not be made, unless all such risks are understood and an independent determination has been made that such transactions would be appropriate. Any discussion of the risks contained herein with respect to any product should not be considered to be a disclosure of all risks or a complete discussion of such risks.

Nothing in this report shall be construed to be an offer or solicitation for the purchase or sale of any product. Any decision to purchase any product mentioned in this research should take into account existing public information, including any registered prospectus in respect of such product.

Phillip Securities Research, or persons associated with or connected to Phillip Securities Research, including but not limited to its officers, directors, employees or persons involved in the preparation or issuance of this report, may provide an array of financial services to a large number of corporations in Singapore and worldwide, including but not limited to commercial / investment banking activities (including sponsorship, financial advisory or underwriting activities), brokerage or securities trading activities. Phillip Securities Research, or persons associated with or connected to Phillip Securities Research, including but not limited to its officers, directors, employees or persons involved in the preparation or issuance of this report, may have participated in or invested in transactions with the issuer(s) of the securities mentioned in this publication, and may have performed services for or solicited business from such issuers. Additionally, Phillip Securities Research, or persons associated with or connected to Phillip Securities Research, including but not limited to its officers, directors, employees or persons involved in the preparation or issuance of this report, may have provided advice or investment services to such companies and investments or related investments, as may be mentioned in this publication.

Phillip Securities Research or persons associated with or connected to Phillip Securities Research, including but not limited to its officers, directors, employees or persons involved in the preparation or issuance of this report may, from time to time maintain a long or short position in securities referred to herein, or in related futures or options, purchase or sell, make a market in, or engage in any other transaction involving such securities, and earn brokerage or other compensation in respect of the foregoing. Investments will be denominated in various currencies including US dollars and Euro and thus will be subject to any fluctuation in exchange rates between US dollars and Euro or foreign currencies and the currency of your own jurisdiction. Such fluctuations may have an adverse effect on the value, price or income return of the investment.

To the extent permitted by law, Phillip Securities Research, or persons associated with or connected to Phillip Securities Research, including but not limited to its officers, directors, employees or persons involved in the preparation or issuance of this report, may at any time engage in any of the above activities as set out above or otherwise hold an interest, whether material or not, in respect of companies and investments or related investments, which may be mentioned in this publication. Accordingly, information may be available to Phillip Securities Research, or persons associated with or connected to Phillip Securities Research, including but not limited to its officers, directors, employees or persons involved in the preparation or issuance of this report, which is not reflected in this material, and Phillip Securities Research, or persons associated with or connected to Phillip Securities Research, including but not limited to its officers, directors, employees or persons involved in the preparation or issuance of this report, may, to the extent permitted by law, have acted upon or used the information prior to or immediately following its publication. Phillip Securities Research, or persons associated with or connected to Phillip Securities Research, including but not limited to its officers, directors, employees or persons involved in the preparation or issuance of this report, may have issued other material that is inconsistent with, or reach different conclusions from, the contents of this material.

The information, tools and material presented herein are not directed, intended for distribution to or use by, any person or entity in any jurisdiction or country where such distribution, publication, availability or use would be contrary to the applicable law or regulation or which would subject Phillip Securities Research to any registration or licensing or other requirement, or penalty for contravention of such requirements within such jurisdiction.

Section 27 of the Financial Advisers Act (Cap. 110) of Singapore and the MAS Notice on Recommendations on Investment Products (FAA-N01) do not apply in respect of this publication.

This material is intended for general circulation only and does not take into account the specific investment objectives, financial situation or particular needs of any particular person. The products mentioned in this material may not be suitable for all investors and a person receiving or reading this material should seek advice from a professional and financial adviser regarding the legal, business, financial, tax and other aspects including the suitability of such products, taking into account the specific investment objectives, financial situation or particular needs of that person, before making a commitment to invest in any of such products.

Please contact Phillip Securities Research at [65 65311240] in respect of any matters arising from, or in connection with, this document.

This report is only for the purpose of distribution in Singapore.

Contact Information (Singapore Research Team)

Management

Chan Wai Chee

(CEO, Research - Special Opportunities)

+65 6531 1231

Joshua Tan

(Head, Research - Equities & Asset Allocation)

+65 6531 1249

Research Operations Officer

Jermaine Tock

+65 6531 1240

Macro | Asset Allocation | Equities

Joshua Tan

+65 6531 1249

Financials

Ken Ang

+65 6531 1793

US Equities

Wong Yong Kai

+65 6531 1685

Telecoms

Colin Tan

+65 6531 1221

Commodities | Offshore & Marine

Nicholas Ong

+65 6531 5440

Real Estate

Lucas Tan

+65 6531 1229

Market Analyst | Equities

Kenneth Koh

+65 6531 1791

Real Estate

Caroline Tay

+65 6531 1792

Contact Information (Regional Member Companies)

SINGAPORE

Phillip Securities Pte Ltd

Raffles City Tower
250, North Bridge Road #06-00
Singapore 179101
Tel +65 6533 6001
Fax +65 6535 6631

Website: www.poems.com.sg

JAPAN

Phillip Securities Japan, Ltd.

4-2 Nihonbashi Kabuto-cho Chuo-ku,
Tokyo 103-0026
Tel +81-3 3666 2101
Fax +81-3 3666 6090

Website: www.phillip.co.jp

THAILAND

Phillip Securities (Thailand) Public Co. Ltd

15th Floor, Vorawat Building,
849 Silom Road, Silom, Bangrak,
Bangkok 10500 Thailand
Tel +66-2 6351700 / 22680999

Fax +66-2 22680921

Website: www.phillip.co.th

UNITED STATES

Phillip Futures Inc

141 W Jackson Blvd Ste 3050
The Chicago Board of Trade Building
Chicago, IL 60604 USA
Tel +1-312 356 9000
Fax +1-312 356 9005

INDIA

PhillipCapital (India) Private Limited

No. 1, C- Block, 2nd Floor, Modern Center,
Jacob Circle, K. K. Marg, Mahalaxmi
Mumbai 400011
Tel: (9122) 2300 2999
Fax: (9122) 6667 9955

Website: www.phillipcapital.in

MALAYSIA

Phillip Capital Management Sdn Bhd

B-3-6 Block B Level 3 Megan Avenue II,
No. 12, Jalan Yap Kwan Seng, 50450
Kuala Lumpur
Tel +603 2162 8841
Fax +603 2166 5099

Website: www.poems.com.my

INDONESIA

PT Phillip Securities Indonesia

ANZ Tower Level 23B,
Jl Jend Sudirman Kav 33A
Jakarta 10220 – Indonesia
Tel +62-21 5790 0800
Fax +62-21 5790 0809

Website: www.phillip.co.id

FRANCE

King & Shaxson Capital Limited

3rd Floor, 35 Rue de la Bienfaisance 75008
Paris France
Tel +33-1 45633100
Fax +33-1 45636017

Website: www.kingandshaxson.com

AUSTRALIA

PhillipCapital

Level 12, 15 William Street,
Melbourne, Victoria 3000, Australia
Tel +61-03 9629 8288
Fax +61-03 9629 8882

Website: www.phillipcapital.com.au

HONG KONG

Phillip Securities (HK) Ltd

11/F United Centre 95 Queensway
Hong Kong
Tel +852 2277 6600
Fax +852 2868 5307

Websites: www.phillip.com.hk

CHINA

Phillip Financial Advisory (Shanghai) Co Ltd

No 550 Yan An East Road,
Ocean Tower Unit 2318,
Postal code 200001
Tel +86-21 5169 9200
Fax +86-21 6351 2940

Website: www.phillip.com.cn

UNITED KINGDOM

King & Shaxson Capital Limited

6th Floor, Candlewick House,
120 Cannon Street,
London, EC4N 6AS
Tel +44-20 7426 5950
Fax +44-20 7626 1757

Website: www.kingandshaxson.com

SRI LANKA

Asha Phillip Securities Limited

No 321, Lakshmans Building,
2nd floor, Galle Road,
Colombo 3, Sri Lanka
Tel: (94) 11 2429 100 Fax: (94) 11 2429 199

Website: www.ashaphillip.net/home.htm