

Offshore & Marine Sector

Results season takeaways

Report type: Update on Rig Builders

Sector Overview

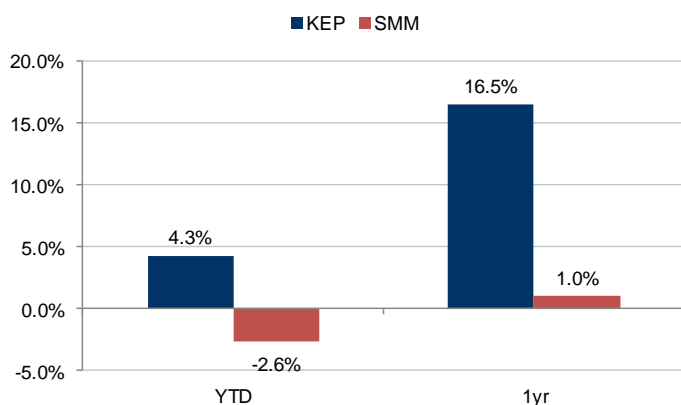
The Offshore & Marine (O&M) Sector under our coverage consists of Rig Builders namely Keppel Corp and Sembcorp Marine. Keppel Corp is a conglomerate that also has property and infrastructure divisions whilst Sembcorp Marine is a pure play to the O&M sector

- No major earnings surprise
- Operating margins rebound stronger than expected
- Outlook remains robust for rig builders

Earnings surprise?

There was no major surprise in the first quarter results. Keppel Corp's results were mostly in-line; earnings were down yoy mainly due to substantial property income reported in 1Q12. Revenue from its O&M segment was slightly lower than expectations, but this was supported by strong margin improvement. Sembcorp Marine's results were slightly below expectations due to low revenue recognition, which was offset by a positive margin surprise.

Fig 1. Total return for the sector



Source: Bloomberg, Phillip Securities Research

Top pick: Keppel Corp

Management from both Keppel Corp and Sembcorp Marine continues to see healthy enquires for drilling rigs, which is indicative of the positive outlook for this sector. We continue to like Keppel Corp for its stronger operating performance, better execution for its Brazilian projects and potential margin upside from the delivery of remaining 15 jack-up rigs for the year (5 delivered in 1Q13). Albeit Sembcorp Marine's order book spike of 150% last year will see higher revenue growth over the next few years, we believe margins continue to face downward pressure as they need to pay learning curve 'tuition fees' for their execution of new design rigs, which in turn affects earnings.

Offshore & Marine Sector

Company	Rating	Price (\$)	TP (\$)	Upside (%)	M.Cap. (SG\$mn)
Rig builder					
Keppel Corp	Accumulate	10.91	12.34	13.1%	19,569
Sembcorp Marine	Neutral	4.42	4.42	0.0%	9,194

Source: Bloomberg, Phillip Securities Research

Analyst

Nicholas Ong

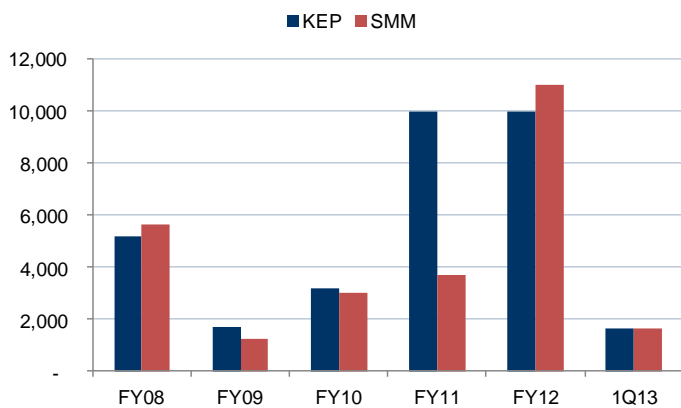
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Order wins/books

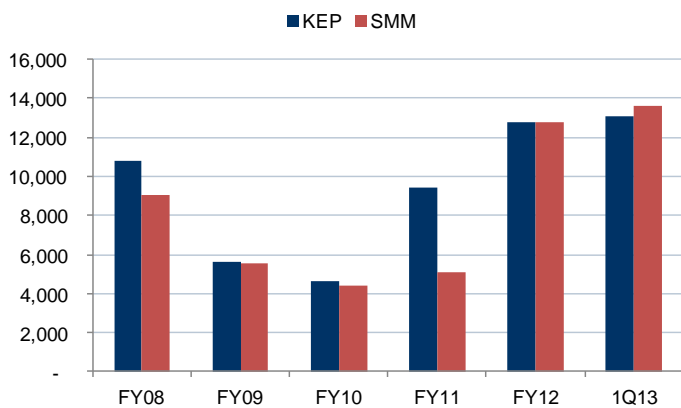
1Q13 has been a healthy quarter in terms of order wins for Keppel Corp as it bagged S\$1.66bn worth of contracts. This included a S\$1bn contract from Grupo R for 4 jack-up rigs based on its proprietary KFELS B Class jack-up rig design. The group has a net order book of S\$13.1bn, with visibility until 2019. Similarly, Sembcorp Marine fared well with total new orders of S\$1.68bn, including S\$778mn worth of contracts for 3 jack-up rigs based on the repeat proprietary Pacific Class 400 jack-up design. The group's net order book is at a record high of S\$13.6bn.

Fig 2. New order wins (\$mn)



Source: Companies, Phillip Securities Research

Fig 3. Net order books (\$mn)

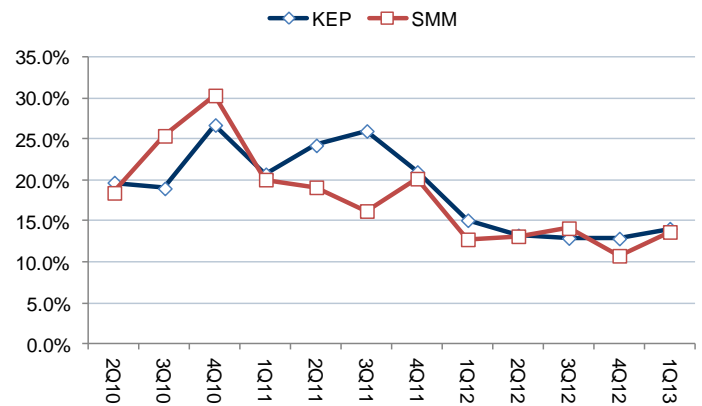


Source: Companies, Phillip Securities Research

Operational performance

In terms of operational performance, we look at the operating margins of both companies. It is evident that margins at both companies have gone up from their lows in 2012. Keppel Corp's operating margin rose qoq to 14.1% in 1Q13 from 12.9% in 4Q12, despite conservative profit recognition from its 1st semi-sub for Sete Brasil, which started revenue recognition in 1Q13. We believe the improvement in margin is mainly due to the higher jack-up rigs deliveries (5 in 1Q13 vs. 1 in 4Q12) as well as the S\$5mn bonuses received for early rig deliveries.

Fig 4. Quarterly operating margins



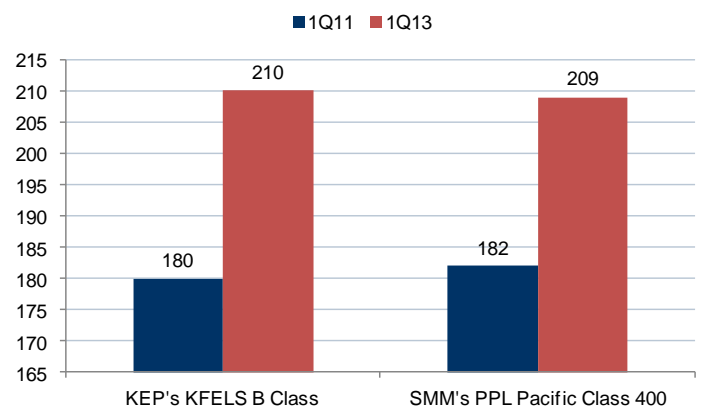
Source: Companies, Phillip Securities Research

Sembcorp Marine's operating margin jumped to 13.7% in 1Q13 from 10.8% in 4Q12, which includes a S\$7mn settlement claims in 1Q13. If we strip away the one-off gains, operating margins would still be high at 13.0%. That said, we expect to see downward pressure on margins as profit recognition for its new design semi-sub and 2nd Sete Brasil drillship, which yield lower margins, kicks-in.

Top pick: Keppel Corp

Management from both Keppel Corp and Sembcorp Marine continue to see healthy enquires for drilling rigs, which is indicative of the positive outlook for this sector. Despite rising competition from the Chinese yards, we think downside risks to Singapore yards are limited in the near and medium term, due to lack of track record from the Chinese, as well as late delivery concerns. In fact, Singapore yards have managed to raise pricing by about 15%-17% 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 5. Pricing of jack-up rigs from SG yards



Source: Companies, Phillip Securities Research

We continue to like Keppel Corp (Accumulate, TP: S\$12.34) for its stronger operating performance, better execution for its Brazilian projects and potential margin upside from the

delivery of remaining 15 jack-up rigs for 2013 (5 delivered in 1Q13). 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 believe margins will continue to face downward pressure as they execute on new design rigs, which in turn will affect earnings.

Fig 6. Singapore offshore & marine sector valuation table

	Rating	FYE	Price	TP	Upside (%)	Market Cap. (SG\$mn)	Equity Multiple (x)		Dividend Yield (%)			
							Net Income	Book Value	13E	14E		
Rig builder							13E	14E	13E	14E		
Keppel Corp	Accumulate	Dec	10.91	12.34	13.1%	19,569	12.7	11.0	2.0	1.9	4.3%	4.5%
Sembcorp Marine	Neutral	Dec	4.42	4.42	0.0%	9,194	16.6	13.9	3.4	3.0	3.2%	3.4%

Source: Bloomberg, Phillip Securities Research

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