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# Sembcorp Marine Ltd

(SMM SP/SCMN.SI)

## Disappointing results; recovery postponed

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- SMM reported a smaller PATMI loss of S\$8.5mn in 2Q19 compared to a loss of S\$55.6mn in 2Q18.
- However, the company has guided for full-year losses to be similar to last year's loss of around S\$74mn.
- Net orderbook excluding the Sete drillship contracts declined to S\$2.1bn as at end 2Q19, compared to S\$3.1bn as at end-2018.
- Given the disappointing results and weak guidance for FY19, we downgrade SMM to Neutral with a fair value of S\$1.59, based on 1.6x FY2019F P/B.

### Financials & Key Operating Statistics

YE Dec (\$\$ m)	2017	2018	2019F	2020F	2021F
Revenue	2387.4	4887.9	3029.9	3749.9	4904.8
PATMI	14.1	-74.1	-79.6	-12.9	31.5
Core PATMI	-37.4	-74.3	-79.6	-12.9	31.5
Core EPS	-1.8	-3.6	-3.8	-0.6	1.5
Core EPS grth (%)	-138.3	na	na	na	na
Core P/E (x)	na	na	na	na	90.1
DPS (SG Cents)	2.0	0.0	0.0	0.0	0.0
Div Yield (%)	1.5	0.0	0.0	0.0	0.0
Net Margin (%)	0.6	-1.5	-2.6	-0.3	0.6
Gearing (%)	111.1	144.4	117.6	123.6	118.3
Price / Book (x)	1.1	1.2	1.2	1.2	1.2
ROE (%)	0.6	-3.2	-3.4	-0.6	1.4

Source: Company Data, KGI Research

**Event:** SMM's 2Q19 performance was a clear disappointment, with full-year guidance of a loss similar to last year's loss of around S\$74mn. Furthermore, order wins have been significantly weaker-than-expected, with only S\$175mn worth of new projects secured in the first six months of FY19. In comparison, Keppel Corp (KEP SP, Neutral, TP S\$7.43) had secured S\$1.9bn of new orders in 1H19, higher than the total value of new orders it secured for the whole of 2018. SMM's net gearing remains elevated at 1.4x as at end-2Q19, a level which we think raises the probability of a rights issue in the next 6-12 months.

**Overhang from Brazil.** The investigations surrounding SMM's Brazil operations may continue to be an overhang on its share price. SMM announced on the 3rd of July that a search warrant was executed on its Brazilian subsidiary, Estaleiro Jurong Aracruz (EJA), in connection with investigations against Guilherme Esteves de Jesus, a former consultant engaged by EJA. He is facing ongoing criminal charges which have not been concluded. The investigations also include Martin Chea, EJA's former president. In the worst-case scenario should SMM be fined US\$422mn - the amount that Keppel Corp was fined in 2017 - our fair value of SMM drops to S\$1.15 (based on 1.6x FY19F P/B, 1 standard deviation below its 20-year average).

**Some good news.** According to media reports, Sete Brasil may be reaching a resolution on the four rigs being constructed by Keppel Corp (KEP SP) and SMM. The tender to sell the rigs received two proposals, one from Magni Partners and the other from KEP. Magni Partners is owned

### NEUTRAL - Downgrade

Price as of 30 Jul 19 (SGD)	1.36	<b>Performance (Absolute)</b>	
12M TP (\$)	1.59	1 Month (%)	-9.9
Previous TP (\$)	2.50	3 Month (%)	-20.5
Upside (%)	16.9	12 Month (%)	-25.7
<b>Trading data</b>		<b>Perf. vs STI Index (Red)</b>	
Mkt Cap (\$mn)	2,842		
Issued Shares (mn)	2,089		
Vol - 3M Daily avg (mn)	5.4		
Val - 3M Daily avg (\$mn)	8.0		
Free Float (%)	37.8%		
<b>Major Shareholders</b>		<b>Previous Recommendations</b>	
Sembcorp Industries	61.1%	21-Feb-19	OW \$2.48
		1-Jan-19	OW \$2.50
		7-May-18	OW \$2.64

by Tor Olav Troim, the chairman of Borr Drilling. The best-case scenario (which is highly likely given that the rigs have 10-year contracts) is that a deal is concluded in 2H19 and the shipyards (SMM and KEP) complete the construction of the four rigs, but at a cost that will have to be negotiated between the new owners and the yards. Overall, we think the resolution of Sete Brasil would be slightly positive for SMM as it would provide greater certainty on the construction timeline.

**Industry recovery.** With 26% of SMM's fixed assets in Brazil, SMM is well-positioned to gain when the oil industry recovers in South America. Already, Rystad Energy reports that final investment decisions (FIDs) for projects over 25mn barrels of oil equivalent (boe) are set to triple YoY in South America in 2019. Brazil is set to lead with 8 projects in 2019 out of a total of 16 FIDs in South America. Globally, the number of project FIDs (>25m boe) has increased from 56 in 2016, to 72 in 2017, 103 in 2018 and is forecasted by Rystad Energy to reach 115 in 2019.

**Valuation & Action: Rock-bottom valuations but uncertainty from Brazil investigations and slow order win momentum.** We downgrade our recommendation to Neutral and lower our fair value to S\$1.59, based on 1 standard deviation below its 20-year P/B average. Although the industry recovery is underway, we expect SMM's earnings to remain weak until 2021 given the intense competition and compressed margins as it diversifies into new projects. The most significant risk in our view is the possibility of a rights issue to lower its high debt level.

**Risks:** Dilutive rights issue or placement exercise to raise funds, especially in the worst-case scenario that it has to pay fines related to its Brazilian operations. Profit margins may continue to be under pressure as SMM diversifies into new projects.

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<b>Outperform (OP)</b>	We take a positive view on the stock. The stock is expected to outperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
<b>Neutral (N)</b>	We take a neutral view on the stock. The stock is expected to perform in line with the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
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