KGI CHINA DEVELOPMENT FINANCIAL

Sembcorp Marine Ltd

(SMM SP/SCMN.SI)

Past cyclical troughs

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- The causes of the decline in oil prices last quarter is reversing. Both the supply and demand side are showing improvement and we thus believe that SMM offers a compelling risk-reward return at current levels.
- We reiterate our BUY recommendation as the fundamental picture improves in the coming quarters.
- In addition to more big offshore projects being approved in 2019, anecdotal evidence suggests that interest is returning to the O&G sector.

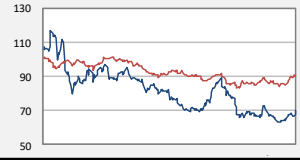
Financials & Key Operating Statistics

YE Dec (S$ m)	2016	2017	2018F	2019F	2020F
Revenue	3544.8	2387.4	4664.0	3359.8	4079.8
PATMI	78.8	14.1	-76.0	52.0	103.0
Core PATMI	97.7	-37.4	-76.0	52.0	103.0
Core EPS	4.7	-1.8	-3.6	2.5	4.9
Core EPS grth (%)	-74.5	-138.3	na	-168.5	98.1
Core P/E (x)	45.1	-117.8	-58.0	84.8	42.8
DPS (SG Cents)	2.5	2.0	1.5	2.0	2.0
Div Yield (%)	1.2	0.9	0.7	0.9	0.9
Net Margin (%)	2.2	0.6	-1.6	1.5	2.5
Gearing (%)	112.7	111.1	150.1	126.6	127.7
Price / Book (x)	1.7	1.8	1.9	1.9	1.8
ROE (%)	3.0	0.6	-3.2	2.2	4.2

Source: Company Data, KGI Research

BUY - Maintain

Price as of 18 Jan 19 (SGD)	1.67	**Performance (Absolute)**	
12M TP ($)	2.50	1 Month (%)	9.2
Previous TP ($)	2.64	3 Month (%)	-9.7
Upside (%)	50%	12 Month (%)	-27.1
Trading data		**Perf. vs STI Index (Red)**	
Mkt Cap ($mn)	3,488		
Issued Shares (mn)	2,089		
Vol - 3M Daily avg (mn)	5.4		
Val - 3M Daily avg ($mn)	8.8		
Free Float (%)	38.7%		
Major Shareholders		**Previous Recommendations**	
Sembcorp Industries	61.1%	7-May-18	BUY $2.64
Franklin Resources	5.0%	26-Feb-18	HOLD $2.06
		2-Nov-17	HOLD $2.05



Event: Oil prices plunged by almost 40% in 4Q18, which in our view, was oversold mainly due to geopolitical reasons. The sell-down was exacerbated by concerns that weak economic data from Asia and Europe would impact the demand side.

The cure for low oil prices is low oil prices. The ramp-up in oil production prior to the Iran sanctions are now being reversed as oil prices weakened in Oct-Dec 2018. Data from the major oil producers are showing declining exports, which means it will soon start filtering to oil prices in the coming weeks. For instance, OPEC's oil output fell by 0.8m barrels per day (mbpd) to 31.6mbpd in December 2018. This is a bullish signal given that OPEC+ (which includes OPEC, Russia & 9 other nations) agreed to cut 1.2mbpd starting January 2019.

Impact: SMM's share price has remained resilient despite the 40% decline in oil price in the last quarter, which we can at least attribute to the 15-year low P/B valuations that it is currently trading at. Hence, with downside primarily mitigated by its rock-bottom valuations, we are of the view that any positive news from new order wins would result in a significant re-rating catalyst.

Past cyclical troughs. LNG could be a significant driver for the offshore sector in 2019, with final investment decisions (FID) on new projects expected to pick up the pace. The FID of LNG Canada in October 2018 was the first major greenfield project since 2015. Meanwhile in Asia, as per Wood Mackenzie's analysis, there will be a need to fill new and old gas infrastructure and drilling of offshore prospects across Australia, Brunei, Malaysia, Myanmar, Pakistan and Papua New Guinea in 2019. Some of the projects will be frontier deepwater exploration. More importantly, Asia-Pacific LNG demand is set to grow 60% by 2030, driven by China that has been responsible for 50% of 2018's global demand growth.

Furthermore, anecdotal evidence from our attendance of O&G seminars is showing renewed interest in the sector. We noticed a 50% increase in attendance to similar O&G events in January 2019 as compared to early 2018. We also noted a more positive tone from SMM's management in 4Q18, where it now expects operating profits in 2019 as work ramps up.

Mega yard site visit. We had the chance to visit SMM's mega Tuas Boulevard Yard (TBY) in Dec-18. The yard is currently carrying out significant projects worth around US$3bn for international offshore firms such as Shell, Transocean and Heerema. As of Nov-18, SMM had spent S$1.8bn on the yard and has built up automated processes to secure projects higher up the value chain.

Valuation & Action:
We reiterate our BUY recommendation on SMM. The key events which drove the crash in oil prices last quarter is now reversing and we are of the view that the recovery in the sector may potentially surprise on the upside. In fact, over the weekend, IEA forecasts that the oil market may potentially return to deficit by as early as 2Q19, driven mainly by production declines from Iran and Venezuela.

Risks: Cancellations from customers remain the most significant risk. Profit margins may continue to be under pressure as SMM diversifies into new projects.

KGI's Ratings

Rating	Definition
	KGI Securities Research's recommendations are based on an Absolute Return rating system.
BUY	>10% total return over the next 12 months
HOLD	-10% to +10% total return over the next 12 months
SELL	<-10% total return over the next 12 months

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