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Offshore and Marine Corporate Day takeaways

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SECTOR REVIEW

Positive but financing remains a concern

- **Offshore and Marine Corporate Day 2012:** Credit Suisse hosted 15 companies and close to 100 investors at our Offshore and Marine Corporate Day on 31 January 2012.
- **Positive outlook for offshore:** Companies across the value chain, including rigbuilders, drilling contractors, offshore support vessel (OSV) builders and charterers, and FPSO operators, were positive on demand for equipment. This is supported by strong oil prices which is driving exploration and production (E&P) spending.
- **Financing is a key concern:** Investors were focused on the impact of the European debt crisis and tighter credit on corporate spending and order flow. While in commercial shipbuilding the lack of financing has led to an evident slowdown in newbuild orders, companies within the offshore segment seem more confident about the availability of bank lending for projects with firm contracts. However, most companies are taking a more cautious approach given ongoing uncertainty, with new entrants in the drilling market preferring to conserve cash rather than to increase their fleet aggressively.
- **Shipbuilding outlook remains bleak:** Chinese shipbuilders remain downbeat on the outlook for newbuild orders in 2012, pointing to oversupply in the commercial vessel market as well as a pullback in lending by European banks. While yards are trying to mitigate the downturn by arranging financing through Chinese banks, our ship financing expert notes that this is available only to “best-in-class” customers, and at more expensive pricing even if successful.
- **Prefer Singapore rigbuilders over Chinese shipbuilders:** We continue to prefer rigbuilders over shipbuilders due to stronger sector fundamentals in the offshore industry. Our top pick is Keppel Corp (OUTPERFORM) due to its strong order book, significant catalyst from the potential Petrobras contract, as well as attractive valuations. Sembcorp Marine (NEUTRAL) could also benefit from Petrobras’ tender for 21 deepwater rigs as a pure-play on the sector. We remain cautious on the Chinese shipbuilders due to concerns on near-term newbuild orders and execution risk in the offshore segment.

Company meeting feedback

Sembcorp Marine

(NEUTRAL, Target price, S$4.00)

- Strong enquiry for high-spec jackups. Resumption of activity at the Gulf of Mexico positive for the deepwater market. Orders for deepwater rigs likely to be placed by national oil companies and established drillers as they are less dependent on availability of financing.
- FPSO market remains strong, but the negotiation process can be extended due to time required for three related parties to agree terms.
- Challenges to building in Brazil include strength of labour unions and ability to handle FX fluctuations when executing long-term projects.
- Experience as a shipbuilder has provided the company greater confidence in building drillships. Key selling point of drillship is a differentiated design that is more compact and easier to maneuver.

Cosco Corp

(UNDERPERFORM, Target price, S$0.60)

- Margins: Current low vessel prices leading to weaker margins in the shipbuilding segment. Expect prices for 57k DWT vessels to remain depressed.
- Orderbook: Most orders have been non-speculative, with 10% or less of current customers from China. Order cancellations unlikely as construction of vessels are already in late stages and customers will have to forfeit progressive payments.
- Ship repair: Number of jobs have increased but contract value of jobs has declined.
- Offshore: Likely to concentrate on deepwater rigs and jackups. Cosco has to be competitive in pricing as it is a new entrant to the market.
- Financing: Banks are still very cautious in their lending.

China Rongsheng Heavy Industries

- Cautious outlook on the shipbuilding sector in 2012, due to oversupply in the market. The company expects ongoing economic uncertainty to lead to lower newbuild contracts in 1H12.
- The company will seek to mitigate downturn through continued expansion into the offshore segment, as it is one of three NDRC approved offshore yards in China. Expect offshore to contribute 20% of revenue in five years. However, do not expect to win significant orders in the near term as contracts are still likely to go to established players. Initial orders likely to be from domestic Chinese customers.
- Expect demand to be weak across bulk carriers, containerships and oil tankers given low profitability of shipowners. Near-term orders likely to be driven by Chinese shipowners.
- Demand for LNG carriers to be better. The company has sent a team to GTT in France to learn about the technology involved in constructing LNG carriers.

- Financing environment continues to be difficult for customers. Chinese banks have little experience in lending to European shipowners, and may take longer time to review loans.

Ship financing expert

Mr Dimitris Belbas, Managing Director, Head of Shipping Finance, Seafin Pte Ltd

- In all three main shipping sectors, freight rates and asset values have declined to historically low levels. Internal rating downgrades in banks have an exponential effect on bank capital. Reduced collateral value also increases capital requirements.
- Pressure on bank finance availability comes from: (1) Provisioning—higher risk costs as borrowers come under financial pressure; (2) Risk migration—increased capital costs with limited portfolio growth; (3) Poor market outlook—oversupply remains; (4) Internal competition for capital—other sectors (offshore) currently have better risk/reward characteristics; (5) Exits—well known shipping banks have exited the market or scaled back.
- It is very challenging for a Chinese bank to assess counterparty risk for a non-Chinese owner, and would hence require a "best-in-class" name. If successful, loans would be provided at more expensive pricing and non-preferential terms and conditions.
- A large number of rights issues were issued post 2008, but subject to window of opportunity. Bond issues served already listed companies, all in the form of non-investment grade with high yields.
- A growing number of private equity funds are becoming attracted to shipping, but the focus is on distressed situations.

IHC Merwede

- Replacement demand for OSVs is driven by the fact that 40% of the current fleet is over 25 years and another 4% falls between 21 and 25 years. Vessels over 25 years are considered non-competitive by oil companies.
- Traditionally, major operators have used IRRs in the range of 12-18% for investment decisions and an oil price of $60-80/bbl.
- Deep water technology and post-Macondo concerns are driving bifurcation in favour of newer/more capable assets.
- Competitive landscape: Pre-2000, Southeast Asian yards have been specialising in building smaller OSVs due to proximity to local shipowners. However, Asian yards are increasingly able to build larger and more sophisticated vessels at lower costs. However, there is still a need for "technology transfer" from the European yards.
- Financing can be a competitive lever in winning contracts, hence the need to grow base in Asia to tap local financing markets.
- Margins from new contracts are lower than the pre-08 levels, but the company seeks to enhance profitability through increasing in-house supplied equipment.

OSV market

Nam Cheong / Otto Marine

- Favourable industry outlook due to strong demand for oil and robust E&P spending which will drive increased demand for OSVs.

- Pickup in enquiries in 2012 across all OSV segments despite charter rates that have remained almost flat. It believes this is driven mainly by replacement demand, with 30% of the existing OSV fleet more than 30 years of age. Recent tenders have required OSVs supplied to be below 15 years in age.
- Financing hard to come by in the market, with customers looking to banks in Asia to fund projects.
- Competitive positioning of yards in different regions: A high labour turnover in Batam yard, with employees likely to move to another yard offering a 10-15% increment; Chinese yards may be better than the Malaysian yards in building complex vessels, but even then there is a wide spectrum of capabilities. Cost to build in Norway is 30-40% higher than in Southeast Asia

Offshore drilling market

Standard Drilling / Mermaid Maritime

- Standard Drilling believes that two major negative drivers that the market got wrong are: (1) the potential economic slowdown will decrease dayrates due to lower oil demand, and (2) the oil reserve replacement of 100% would keep production flat placing downward pressure on oil prices.
- On a BTU equivalent basis, oil traded at 1.3x premium to natural gas in 4Q08. Today, oil trades at a 6.7x premium to natural gas. Therefore, the focus is on drilling which can immediately increase oil production, and must be driven by jackups.
- The key driver of demand for jackup rigs is likely to be PEMEX, North Sea, and Gulf of Mexico.
- Recent fixtures indicate a US$150,000 market for dayrates, with contract terms continuing to lengthen indicating a tightening market.
- Financing is the number one issue for 2012, and will be a key area of focus for both companies.
- Singapore rigbuilders remain best-in-class, with minimal risk of delivery delays which can be dire to new entrants to the market. The key competitive strength of Chinese yards is in the more attractive payment terms issued (1% downpayment and 99% on delivery).

FPSO market

EOC/Bumi Armada

- EOC believes that a surge in drilling rig orders/deliveries is a positive leading indicator for production demand. FPSO's mobility, cost and operational characteristics are well-suited for deepwater and marginal fields. 25-50% more FPSOs expected to be in demand over next five years. Limited supply of operators/lessors, and high barriers to entry.
- EOC's strategy is to capitalise on its strength in Asia and also expand into West Africa and the North Sea.
- Financing: Asia remains robust with key Asian financial centres providing good platforms for equity and debt funding. EOC will also look to explore alternative sources of capital including tapping Export Credit potential and enlist Mezzanine Financing.

Figure 1: Companies which presented at Credit Suisse Offshore and Marine Corporate Day 2012

Country	Company name	Bloomberg Code
Malaysia	Bumi Armada Berhad	BAB MK
China	China Rongsheng Heavy Industries	1101 HK
Singapore	COSCO Corporation (Singapore) Ltd	COS SP
Singapore	EOC	EOC NO
Singapore	Ezion Holdings	EZI SP
Singapore	Jasper Investments	JASP SP
Malaysia	Kencana/ SapuraCrest	KEPB MK/ SCRES MK
Thailand	Mermaid Maritime	MMT SP
Malaysia	Nam Cheong	NCL SP
Singapore	Otto Marine	OTML SP
Singapore	SembCorp Marine	SMM SP
Norway	Standard Drilling	SDSD NO
Netherlands	IHC Merwede	Private

Source: Company data, Credit Suisse estimates

Companies Mentioned *(Price as of 31 Jan 12)*
Bumi Armada (BUAB.KL, RM3.95, OUTPERFORM, TP RM4.20)
China Rongsheng (1101.HK, NOT RATED)
COSCO Corporation (Singapore) Ltd (COSC.SI, S$1.18, UNDERPERFORM, TP S$0.60)
EOC Limited (EOCL.OL, NOT RATED)
Keppel Corporation (KPLM.SI, S$10.85, OUTPERFORM, TP S$12.40, OVERWEIGHT)
Mermaid Maritime (MMPC.SI, NOT RATED)
Nam Cheong (NMCG.SI, NOT RATED)
Otto Marine (OTTO.SI, NOT RATED)
Petrobras (PBR, $30.55, NEUTRAL, TP $34.00)
Sembcorp Marine Ltd. (SCMN.SI, S$4.97, NEUTRAL, TP S$4.00, MARKET WEIGHT)
Standard Drilling (SDSD.OL, NOT RATED)

Disclosure Appendix

Important Global Disclosures

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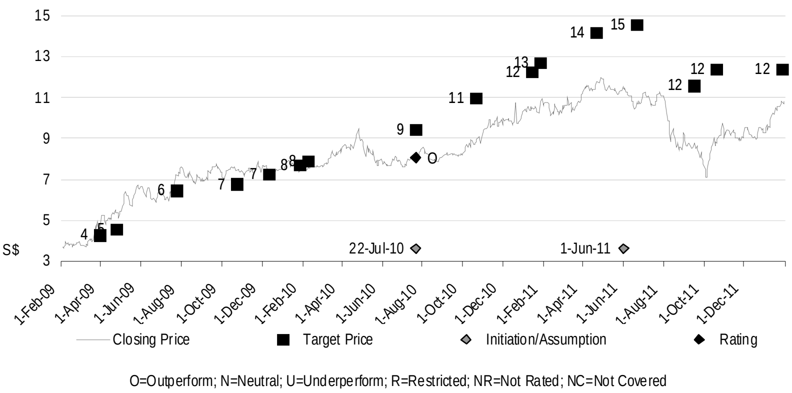
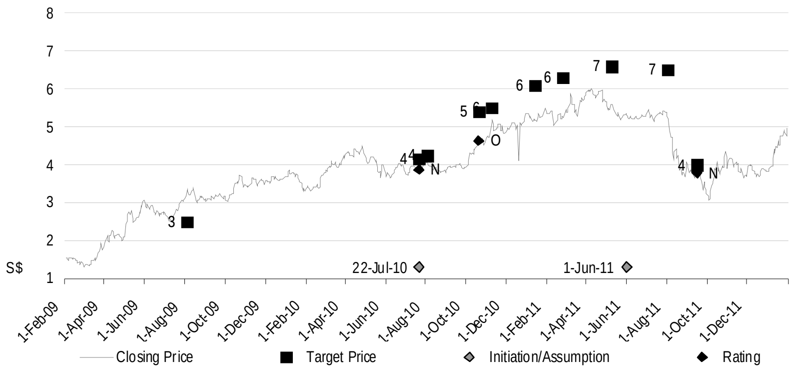
3-Year Price, Target Price and Rating Change History Chart for KPLM.SI

KPLM.SI Date	Closing Price (S$)	Target Price (S$)	Rating	Initiation/ Assumption
31-Mar-09	4.555	4.273		
24-Apr-09	5.355	4.546		
24-Jul-09	7.255	6.455		
23-Oct-09	7.409	6.773		
11-Dec-09	7.446	7.273		
27-Jan-10	7.418	7.727		
9-Feb-10	7.582	7.892		
22-Jul-10	8.046	9.455	O	X
20-Oct-10	8.773	11		
14-Jan-11	10.527	12.273		
26-Jan-11	10.836	12.727		
21-Apr-11	11.764	14.182		
1-Jun-11				X
22-Jun-11	10.68	14.6		
16-Sep-11	8.75	11.6		
20-Oct-11	8.78	12.396		
27-Jan-12	10.85	12.405		



3-Year Price, Target Price and Rating Change History Chart for SCMN.SI

SCMN.SI Date	Closing Price (S$)	Target Price (S$)	Rating	Initiation/ Assumption
5-Aug-09	3.36	2.5		
22-Jul-10	3.88	4.15	N	X
4-Aug-10	4	4.25		
20-Oct-10	4.64	5.4	O	
8-Nov-10	4.93	5.5		
14-Jan-11	5.18	6.1		
24-Feb-11	5.28	6.3		
10-May-11	5.6	6.6		
1-Jun-11				X
3-Aug-11	5.22	6.5		
16-Sep-11	3.79	4	N	



O=Outperform; N=Neutral; U=Underperform; R=Restricted; NR=Not Rated; NC=Not Covered

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Price Target: (12 months) for (KPLM.SI)
Method: Our TP $12.40 is based on a SOTP valuing 1) 14x O&M 2012E EPS. 2) CS target prices for Keppel Land (S$2.92), KREIT (S$1.16), 3) Mark-to-market value of other listed entities, and 4) asset value estimates of Keppel Bay and the infrastructure business.
Risks: Risks to our target price of S$12.40 for Keppel Corp include the following:1) slower than expected recovery in the offshore & marine or property cycles; 2) limited earnings visibility on infrastructure business and 3) limited disclosure on individual businesses.
Price Target: (12 months) for (SCMN.SI)
Method: Our SOTP value of S$4.00 is based on: 1) 14x O&M 2012E earnings per share (EPS), 2) SMM's stake in Cosco Shipyard and 3) SMM's equity stake in COSCO Corp.
Risks: The risks to SembCorp Marine achieving our target price of S$4.00 are: 1) changes in the oil and rig day rate prices, 2) a rebound in world economic growth, and 3) a shift in capital expenditure of drillers to drill ships, and 4) Changes in value or operating risk pertaining to COSCO Corp.

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