

### SECTOR UPDATE

## Offshore Marine – Singapore

Continued Healthy Demand For Production Assets, Helped By Strong Oil Prices

The rig market, particularly the semi-submersibles segment, has continued to gain strength in 2022 with higher utilisation and day rates. On the production side, it is notable that both of Singapore's shipyards have won large orders in 2H22 and we expect more of such in 2023, underpinned by oil prices that will be well supported above US\$100/bbl in the near to medium term. Our sector rating remains **OVERWEIGHT**, and our top picks are Keppel Corp and Sembcorp Marine.

### WHAT'S NEW

- **The offshore market has gotten tighter**, with utilisation rates back above pre-pandemic levels (see chart on RHS), while day rates for semi-submersibles in particular have been extremely strong. Ytd, only 10 rigs have been taken out of the global market either via recycling or conversion. However, we note that the M&A market is a lot more active with 45 rigs changing hands vs only 20 in 2021, and the highest since 2017. Compared to 2019, the global offshore rig industry has lost 57 competitive rigs (-9%) to 598 rigs as at early-Nov 22. In our view, this is positive as the extraction of excess supply should allow utilisation and day rates to continue to further firm up going forwards.
- **More rigs being re-activated.** In the face of higher utilisation levels, more and more rigs across the three asset classes have been reactivated as we note that the percentage of warm- and cold-stacked rigs have declined by 10-33% yoy (see chart on the next page). In addition, we highlight that there are 437 rigs currently drilling globally vs 400 in 4Q20.
- **Bullish FPSO outlook.** In its latest 3Q22 floating production systems report, Energy Maritime Associates (EMA) stated that 192 production projects are in the 'visible planning cycle', an increase of nine from 1Q22, which implies a bullish outlook for new orders. Importantly, EMA notes that 65 are in the bidding or final design stage as available LNG and alternatives to Russian gas are creating demand for quick import terminals. In our view, Sembcorp Marine (SMM) and Keppel Corp (KEP) should be well placed to win some of these orders in 2023.
- **We believe Brent oil prices will be well supported above US\$100-110 over the next 3-6 months.** The physical market for energy continues to be tight, signalling that demand continues to outpace supply. In our view, supply dynamics will likely outweigh any demand destruction and continue to push oil prices higher over the coming quarters. After the US mid-term elections with power evenly split between Republicans and Democrats, continued US Strategic Petroleum Reserve drawdowns may be more difficult. Given the structural undersupply of energy and the lack of capex and supply response by producers, the long-term case for energy remains bullish, in our view.

### ACTION

- **Maintain OVERWEIGHT on the sector.** We continue to like KEP and SMM which have combined orders of just over S\$15b ytd. In our view, this bodes well for the merger which is expected to be completed by 1Q23, especially given that the transaction has now been made much simpler.

### PEER COMPARISON

Company	Ticker	Rec	Price (Icy)		Upside to TP (%)	Market Cap (US\$m)	PE (x)		P/B (x)		EV/EBITDA (x)		ROE% 2023F	Yield (%) 2023F
			22 Nov	Target			2022F	2023F	2022F	2023F	2022F	2023F		
Keppel Corp	KEP SP	BUY	7.41	10.11	36.4	9,407	15.8	14.7	1.1	1.0	14.7	13.6	7.2	2.7
Sembcorp Industries	SCI SP	BUY	3.20	4.10	28.1	4,124	8.0	10.8	1.3	1.2	9.4	10.6	12.1	2.8
Sembcorp Marine	SMM SP	BUY	0.131	0.156	19.1	2,980	n.a.	96.0	1.1	1.1	32.4	25.6	1.2	0.0
Yangzijiang	YZJSGD SP	HOLD	1.37	1.55	13.1	3,922	9.9	8.4	1.7	1.3	2.9	2.6	17.8	3.1
<b>Average – Spore-listed</b>							<b>11.2</b>	<b>32.5</b>	<b>1.3</b>	<b>1.2</b>	<b>14.9</b>	<b>13.1</b>	<b>9.6</b>	<b>2.2</b>
Daewoo Shipbldg	042660 KS	NR	19,500	NA	NA	1,543.0	NM	21.8	1.5	1.7	NM	11.6	4.7	NA
Samsung Heavy Ind	010140 KS	NR	5,160	NA	NA	3,366.6	NM	77.7	1.1	1.1	NM	19.7	1.5	0.3
Korea Shipbuilding	009540 KS	NR	78,300	NA	NA	4,090.1	NM	13.4	0.6	0.5	NM	7.2	4.1	3.2
<b>Average – Sector</b>							<b>11.2</b>	<b>34.7</b>	<b>1.2</b>	<b>1.1</b>	<b>14.9</b>	<b>13.0</b>	<b>6.9</b>	<b>2.0</b>

Note: NR = Not Rated, based on Bloomberg consensus  
Source: Bloomberg, UOB Kay Hian

## OVERWEIGHT

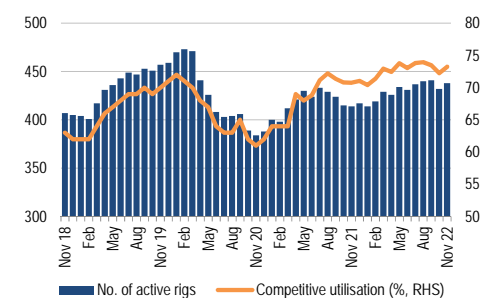
(Maintained)

### SECTOR PICKS

Company	Ticker	Rec	Price (S\$)	
			22 Nov	Target
Keppel Corp	KEP SP	BUY	7.41	10.11
Sembcorp Industries	SCI SP	BUY	3.20	4.10
Sembcorp Marine	SMM SP	BUY	0.131	0.156
Yangzijiang	YZJSGD SP	HOLD	1.37	1.55

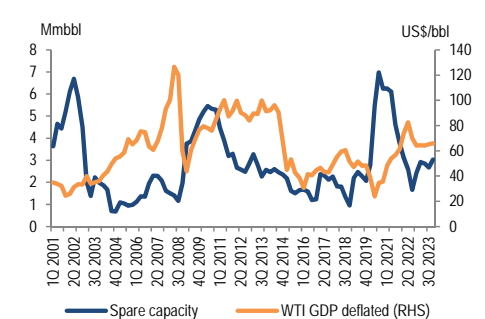
Source: Bloomberg, UOB Kay Hian

### NO. OF ACTIVE OFFSHORE RIGS VS. UTILISATION



Note: Excludes rigs in repair/special survey which number c.2-3 per year  
Source: Basso Analytics

### OPEC SPARE CAPACITY VS WTI OIL PRICE



Source: US Energy Information Administration

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### ESSENTIALS

- Large numbers of jack-up rigs limiting upside.** Higher drilling demand has seen more jack-ups being put to work. However, it appears that the weight of supply has limited upside on day rates as well as utilisation rates. The average utilisation rate for 300-foot independent cantilevered jack-ups has risen to nearly 68%; however, day rates remain in the doldrums, averaging US\$83,500/day ytd vs 2017's average of US\$129,000.
- Deepwater drilling seeing much better supply/demand dynamics.** Deepwater drilling assets have seen better recovery in utilisation rates and day rates. For the sixth-generation drillships in particular, rig-owners such as Transocean and Valaris have stated their belief that day rates will exceed US\$400,000/day in 2023 vs average drillship dayrates of over US\$330,000/day at present.
- Oil demand expected to grow, but forecasts face heightened uncertainty.** In its latest Nov 22 update, the US Energy Information Administration (EIA) forecasts oil demand growth of 2.5mmbpd and 1.5mmbpd for 2022 and 2023 respectively (see chart on RHS). Note that since Jan 22, the US EIA has gradually downgraded 2023 oil demand growth from its original forecast of 1.8mmbpd growth. It has highlighted that its forecast is subject to "heightened levels of uncertainty" resulting from a variety of factors, including Russian oil sanctions as well as less robust global economic activity. Note that an additional Russian oil embargo goes into effect on 5 Dec 22, banning the provision of shipping, insurance and other services related to Russian oil, and if China continues to open up, this would result in tighter oil and natural gas markets in the near term.

### 3Q22 BUSINESS UPDATE RECAP

#### Keppel Corp (KEP SP/BUY/Target: S\$10.11)

- KEP reported a strong 3Q22 business update** with revenue rising 24% yoy to S\$6.8b and above our expectations. While the company did not disclose net profit numbers for 3Q22, it did state that net profit was lower yoy due to the high-base effect of lumpy en bloc sales which boosted 3Q21 profits. The two key segments that performed well was energy & environment and asset management while, as expected, management sounded bearish on its China property business.
- We have a BUY rating on KEP with a SOTP-based target price of S\$10.11.** The company appears to be at an interesting cross-roads in 2022 with: a) the exit of its KOM segment, and b) its move towards a more asset-light and recurring earnings business model, and towards its 15% ROE target vs 9.1% in 2021 and 1H22 annualised ROE of 8.4%. Of interest will be the pace of its asset monetisation which could bolster earnings again in 2022 and thus lead to another dividend surprise.

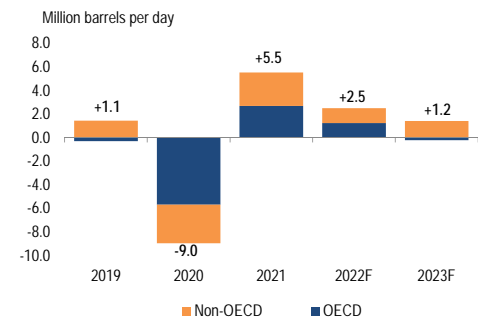
#### Sembcorp Marine (SMM SP/BUY/Target: S\$0.156)

- SMM's 3Q22 business update contained weaker-than-expected guidance for 2H22.** Although we have raised our loss estimates for 2022 due to high labour costs, we believe the latter will not be an issue after end-22. Nevertheless, we maintain our bullish view on the company as the offshore marine industry remains strong, backed by high commodity prices, with the added benefit of the completion of the merger with KOM in 1Q23. We also highlight the potential for SMM to be added to the Straits Times Index after its merger is completed.
- Maintain BUY with a target price of S\$0.156.** With the SMM/Keppel merger terms largely in place and the uncertainty out of the way, the focus on SMM will be to garner new orders in 2022 and add to its orderbook. Our target book-value multiple for SMM of 1.2x reflects our confidence that it will garner such order thus leading to positive share price performance.

#### Yangzijiang Shipbuilding (YZJSGD SP/HOLD/Fair value: S\$1.55)

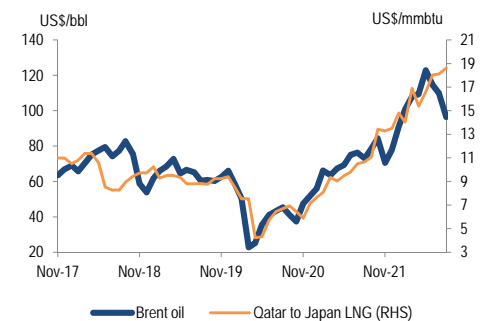
- After its 3Q22 business update, we downgraded YZJ to a HOLD.** While its 3Q22 update showed solid project execution with the continued timely delivery of its customers' ultra-large containerships, its recent share price performance has been strong. In addition, with its yard capacity full until at least 2H25, and new order wins unlikely to be announced until later in 1Q23, we see few catalysts for YZJ's share price at present.

### INCREMENTAL OIL DEMAND GROWTH PER YEAR



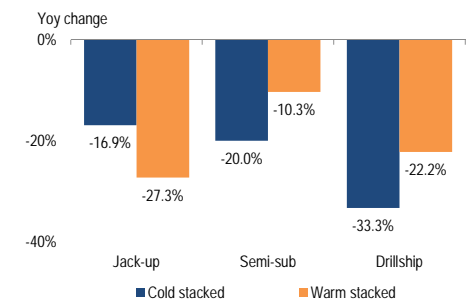
Source: US Energy Information Administration (Sep 21)

### BRENT OIL PRICE VS LNG CONTRACT PRICE



Source: Bloomberg

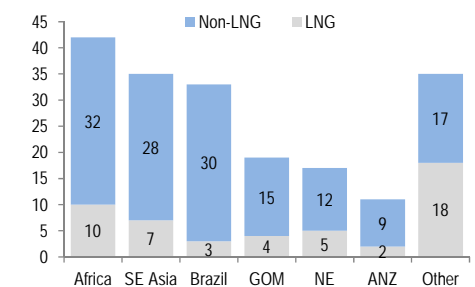
### YOY CHANGE IN STATUS OF GLOBAL RIGS



Note: Excludes rigs in repair/special survey which number c. 1-3 per year

Source: Bassoe Analytics

### OFFSHORE PROJECTS IN PLANNING PIPELINE BY REGION (NO. OF UNITS)



Note: GOM = Gulf of Mexico, NE = Northern Europe, ANZ = Australia/New Zealand

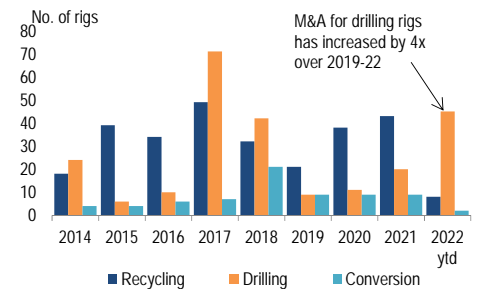
Source: Energy Market Associates

• **Maintain HOLD with a fair value of S\$1.55.** Our target PE multiple of 9.0x is unchanged and is 1SD above the YZJ's past five-year average of 6.7x which we view as fair given the company's earnings growth in 2023, as well as the stability of its earnings due to its US\$10.3b orderbook at present. We note that at our fair value of S\$1.55, YZJ would trade at a 2023F P/B of 1.3x.

### RISKS TO OUR THESIS

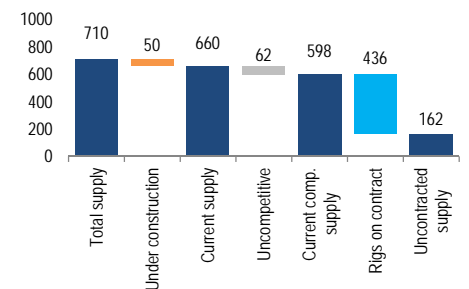
- Delays in project sanctioning due to supply chain inflationary pressures.
- Lack of financing for industries that are seen to be related to the fossil fuel industry.
- Despite the high oil prices resulting in super-normal free cash flow, oil companies may remain wary of committing to offshore capex and instead focus on share buybacks or paying dividends.

### RIG SALES BY TYPE



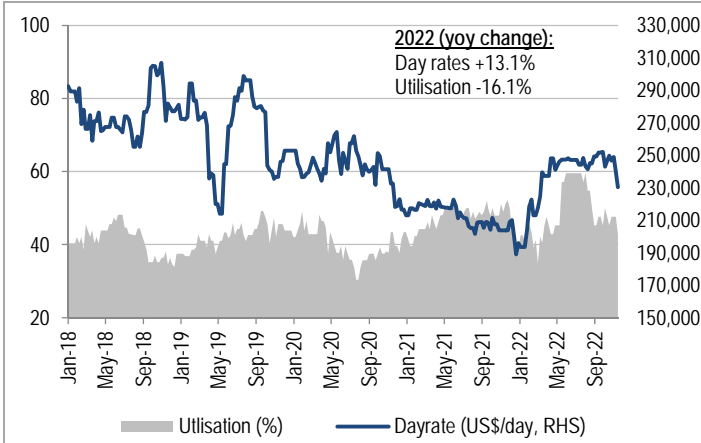
Source: Bassoe Analytics

### TOTAL SUPPLY OF RIGS IN THE GLOBAL MARKET



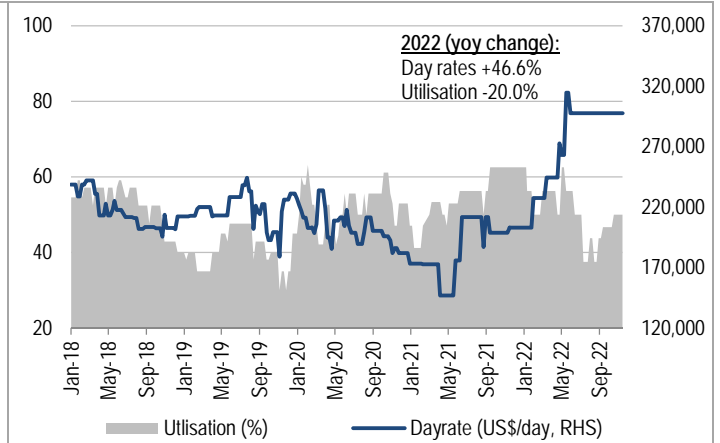
Source: Bassoe Analytics

### DAYRATE & UTILISATION: SEMISUB 8000'



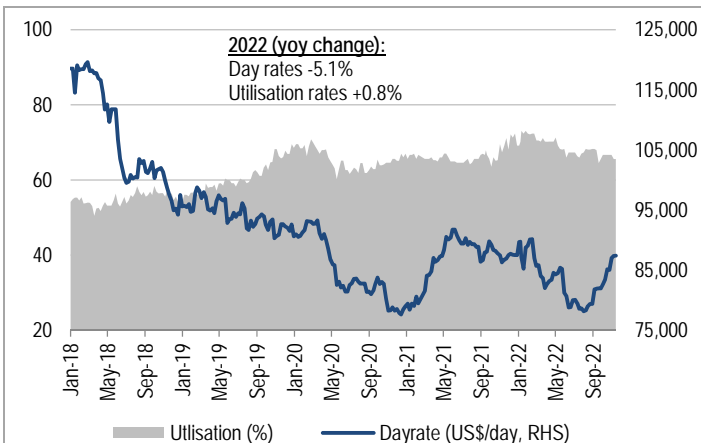
Source: Rigzone, Bloomberg

### DAYRATE & UTILISATION: SEMISUB 5000-8000'



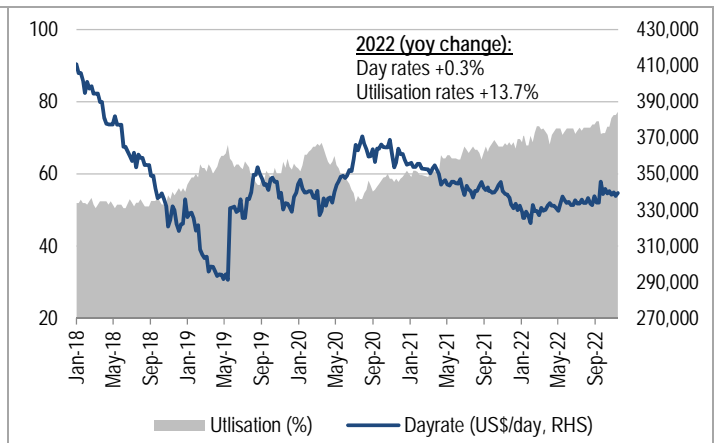
Source: Rigzone, Bloomberg

### DAYRATE & UTILISATION: JACKUP 300+ IC



Source: Rigzone, Bloomberg

### DAYRATE & UTILISATION: DRILLSHIP



Source: Rigzone, Bloomberg

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