

SECTOR UPDATE

Offshore Marine – Singapore

2023: Building On The Strength Seen In 2022, We Expect A Strong Year Ahead

In 2023, we expect the global rig market to continue the strength seen in 2022 with higher utilisation and day rates. The oil & gas industry is forecast to see double-digit capex growth over 2023-24. While some of this capex increase is inflation related, we point out that there are over 180 offshore projects that will require floating production and or storage systems which would benefit our top picks SMM and KEP. Our sector rating remains **OVERWEIGHT**.

WHAT'S NEW

- **Tightness driving utilisation higher.** Competitive utilisation rates spiked in Jan 23 to above 80% (see chart on RHS), a level not seen since prior to 2018 and despite the fact that the number of active rigs has increased 8% yoy. While aggregate jack-up dayrates are flat on a yoy basis, industry reports indicate that dayrates for high-specification jack-ups have hit five-year highs of nearly US\$140,000/day while semi-sub and drillships have seen dayrates increase by 6-47% yoy.
- **More rigs being re-activated.** In the face of higher utilisation levels, more rigs across the three asset classes have been reactivated. In particular, warm-stacked rigs, which are cheaper to reactivate vs cold-stacked rigs, have declined by between 16-47% yoy (see chart on the next page). As a result, there are currently 446 rigs drilling globally vs 400 in Jan 20, with only 102 uncontracted rigs at present vs 252 in 2019.
- **Firm outlook for offshore capex.** As can be seen by the chart on the RHS, IHS Market forecasts a 13% CAGR for offshore upstream capex over the 2021-24 period after a multi-year decline over the 2015-21 period. Other industry surveys are even more bullish with a forecast of a 24% yoy increase in 2023 (vs 12% growth in 2022). However it should be noted that the industry has attributed the majority of the 2022 and 2023 capex increase to inflation and also supply chain issues rather than demand-led price increases. The key risk is that oil companies continue to favour share buybacks instead of capex spending: note Chevron's and Exxon's unprecedented announcements of US\$75b and US\$50b share buybacks recently.
- **Orders for offshore production assets still very feasible** over the next 24 months, as evidenced by the fact that there are 182 projects globally in the appraisal, planning or bidding/final design stages - these will require floating production or storage systems which Keppel Corp (KEP) and Sembcorp Marine (SMM) are exposed to. Importantly, the major hardware contracts for nearly half of these projects are due around 2023-26, and at present, it appears that studies are ongoing to assess the economic viability of these, in particular the projects that are in harsh and/or deepwater environments.

ACTION

- **Maintain sector view at OVERWEIGHT.** We continue to like SMM and KEP which combined have seen over S\$15b worth of orders in 2022. In our view, this bodes well for the merger which is expected to be completed in the next few months, 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%	Yield (%)
			30 Jan	Target			2023F	2024F	2023F	2024F	2022F	2023F		
Keppel Corp	KEP SP	BUY	7.56	10.11	33.7	10,080	15.0	13.6	1.1	1.0	14.0	13.3	7.2	2.7
Sembcorp Industries	SCI SP	BUY	3.58	4.10	14.5	4,870	11.9	11.5	1.4	1.3	9.1	8.9	12.1	2.6
Sembcorp Marine	SMM SP	BUY	0.141	0.156	10.6	3,368	104.1	58.7	1.3	1.2	21.1	18.7	1.2	0.0
Yangzijiang	YZJSGD SP	BUY	1.24	1.55	25.0	3,734	7.6	6.9	1.1	1.0	3.7	3.4	17.8	3.3
Average – Spore-listed							34.7	22.7	1.2	1.1	12.0	11.1	9.6	2.2
Daewoo Shipbldg	042660 KS	NR	21,900	NA	NA	1,920	NM	43.3	1.6	1.9	NM	15.5	4.4	0.0
Samsung Heavy Ind	010140 KS	NR	5,270	NA	NA	3,791	NM	102.5	1.2	1.1	NM	20.1	1.1	0.0
Korea Shipbuilding	009540 KS	NR	77,600	NA	NA	4,482	NM	12.5	0.6	0.5	NM	6.7	4.3	3.5
Average – Sector							34.7	24.4	1.2	1.1	12.0	12.4	6.9	1.7

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

OVERWEIGHT

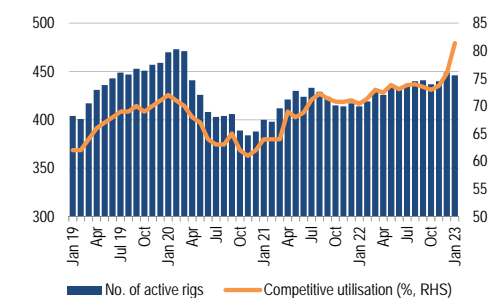
(Maintained)

SECTOR PICKS

Company	Ticker	Rec	Price (S\$)	
			30 Jan	Target
Keppel Corp	KEP SP	BUY	7.56	10.11
Sembcorp Industries	SCI SP	BUY	3.58	4.10
Sembcorp Marine	SMM SP	BUY	0.141	0.156
Yangzijiang	YZJSGD SP	BUY	1.24	1.55

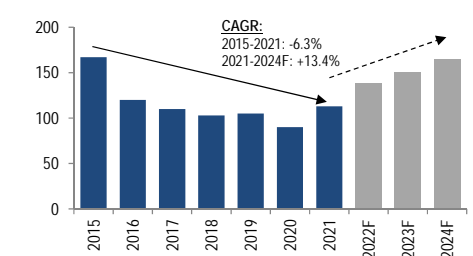
Source: Bloomberg, UOB Kay Hian

NO. OF ACTIVE OFFSHORE RIGS VS. UTILISATION



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

GLOBAL OFFSHORE UPSTREAM CAPEX



Source: IHS Market

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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 in dayrates as well as utilisation rates. For the first time in nearly 10 years, average utilisation rates for 300-foot independent cantilevered jack-ups rose above 70%. However at present, dayrates remain stuck between US\$75,000-85,000 per day in the past three years vs an average of US\$129,000 in 2017.
- Deepwater drilling – much better supply/demand dynamics.** Deepwater drilling assets have seen better recovery in utilisation rates and dayrates. For its latest eighth-generation drillship “Deepwater Titan” that will work in the Gulf of Mexico, Transocean has contracted it to Chevron at US\$455,000 per day vs average drillship dayrates of over US\$330,000/day at present. Esgian Rig Services expects drillship dayrates to head above US\$500,000 per day in 2023.
- Oil demand expected to grow, but forecasts face heightened uncertainty.** In its latest Jan 23 update, the US Energy Information Administration (EIA) forecasts oil demand growth of 1.0mmbpd and 1.7mmbpd for 2023 and 2024 respectively (see chart on RHS). The agency continues to highlight that ongoing concerns about global economic conditions as well as the easing COVID-19 restrictions in China, however, increase the uncertainty of the outcomes of (its) demand forecasts.

2022 RESULTS PREVIEW

REVENUE AND PROFIT ESTIMATES FOR SHIPYARDS & INDUSTRIALS SECTOR

Year to 31 Dec	Revenue (\$m)		Profit (\$m)		UOB vs consensus 2022F
	2021	2022F	2021	2022F	
Keppel Corp	8,625	8,203	941	979	7.7%
Sembcorp Industries	7,795	10,613	279	732	-10.4%
Sembcorp Marine	1,862	1,939	-1,171	-249	0.8%
Yangzijiang (RMBm)	16,768	20,533	3,699	2,826	11.2%

Source: UOB Kay Hian, Bloomberg

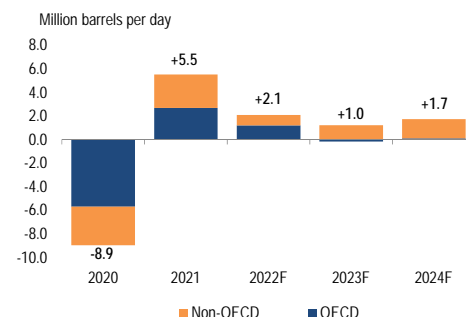
Keppel Corp. (KEP SP, BUY, target price S\$10.11)

- In late-Oct 22, KEP reported a strong 9M22 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 in 3Q22 were the infrastructure and offshore & marine businesses which saw 51% and 56% yoy increase in revenue respectively. While management sounded bearish on its China property business at that time, we highlight that sentiment has materially changed in the country since Oct 22 and this segment will outperform in 2023 in our view. Our 2023 net profit estimates are about 8% higher than Bloomberg consensus numbers.
- Asset monetisation and potential dividend upside.** Of interest at its 2022 results will be the pace of its asset monetisation which could bolster earnings again in 2022 and thus lead to the company announcing another dividend surprise. Note that KEP declared an S\$0.15 dividend for 1H22 (1H21: S\$0.12) vs our forecast of S\$0.30 for 2022: in our view the company is highly likely to beat our dividend expectations.
- We have a BUY rating on KEP with an SOTP-based target price of S\$10.11.** The company has entered 2023 on the cusp of a material change in its business model given the exit of its Keppel Offshore & Marine segment and moving towards more asset-light and recurring earnings businesses. In our view, the company is well on the road towards its 15% ROE target vs 9.1% in 2021 and 1H22 annualised ROE of 8.4%.

Sembcorp Marine (SMM SP, BUY, target price S\$0.156)

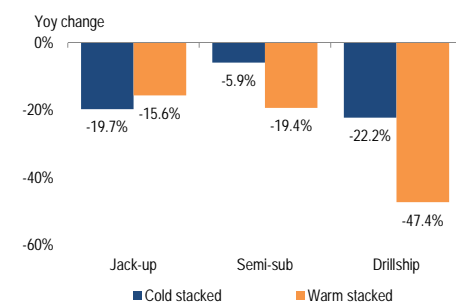
- Looking past 2022 results.** After its 3Q22 business update, we increased our loss estimates for 2022 due to higher-than-expected labour costs, however we do not believe that the market is focused on SMM's 2022 financial performance but rather its prospects going forward. SMM is currently our top pick in the sector as we believe that the offshore marine

INCREMENTAL OIL DEMAND GROWTH PER YEAR



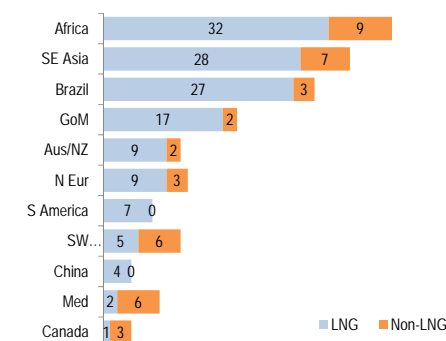
Source: US Energy Information Administration (Jan 23)

YOY CHANGE IN STATUS OF GLOBAL RIGS



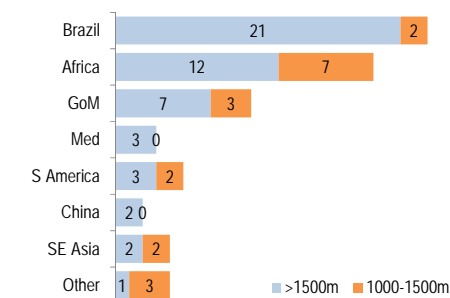
Note: Excludes rigs in repair/special survey which number c.1-3 per year
Source: Basso Analytics

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



Note: GoM = Gulf of Mexico, N Eur = Northern Europe, ANZ = Australia/New Zealand, Med = Mediterranean
Source: Energy Market Associates

DEEPWATER AND ULTRA DEEPWATER PROJECTS IN THE PLANNING PIPELINE BY REGION



Source: Energy Market Associates

industry will benefit from high commodity prices. We also highlight the potential for SMM to be added to the Straits Times Index after the completion of its merger.

- **Maintain BUY with S\$0.156 target price.** 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 2023 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.

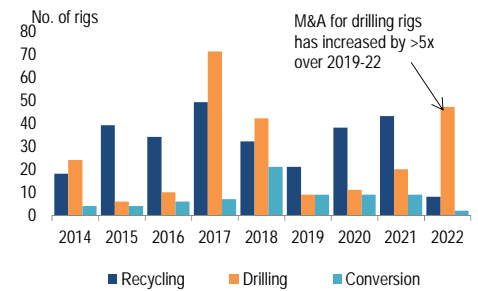
Yangzijiang Shipbuilding (YZJSGD SP, BUY, fair value S\$1.55)

- **On 5 Jan 23, we upgraded YZJ to a BUY from HOLD** after a two-month period of share price underperformance. We strongly believe that the company will continue its stellar track record of project execution with the timely delivery of its customers' ultra-large containerships and potentially see its shipbuilding margins expand in 2023. With its yard capacity full until at least 2H25, YZJ's business outlook remains solid with the company likely to announce new order wins later in 1Q23.
- **Our target price of S\$1.55** is based on a target PE multiple of 9.0x which is +1SD above the company'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 current US\$10.3b orderbook. We note that at our fair value of S\$1.55, YZJ would trade at a 2023F P/B of 1.3x. At end-1H22, the company had S\$0.19/share in cash and will likely have seen this grow meaningfully in 2H22. Given its low levels of capex in both 2023 and 2024, we believe that the company will be in a good position to return some of this cash to its shareholders.

RISKS TO OUR THESIS

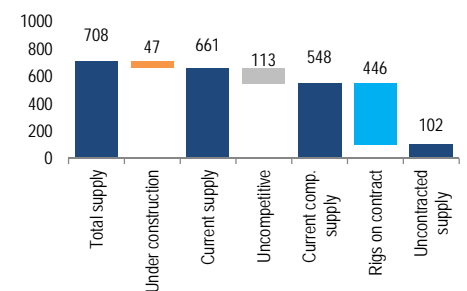
- Delays in project sanctioning due to supply chain inflationary pressures.
- Lack of financing for industries that are seen to be related to the fossil fuel industry.
- Despite the high oil prices resulting in super-normal free cash flow, oil companies may remain wary of committing to offshore capex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

RIG SALES BY TYPE



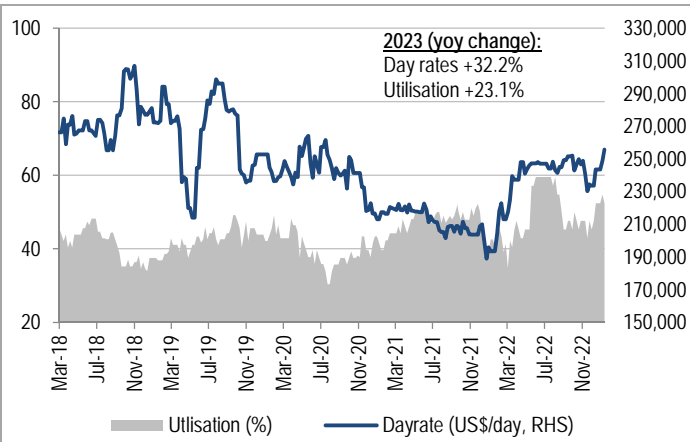
Source: Bassoe Analytics

TOTAL SUPPLY OF RIGS IN THE GLOBAL MARKET



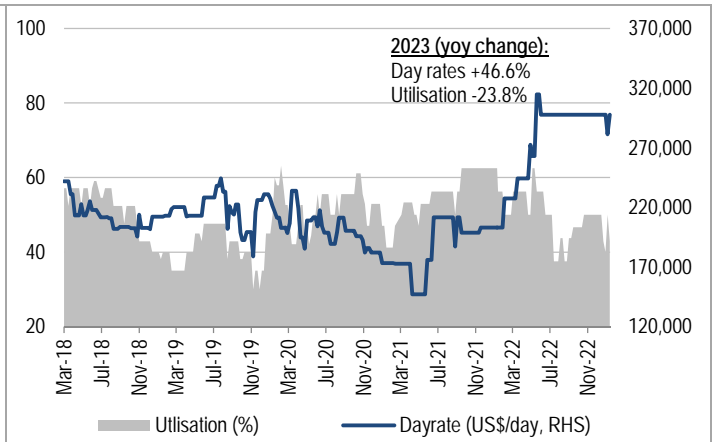
Source: Bassoe Analytics

DAYRATE & UTILISATION: SEMISUB 8000'



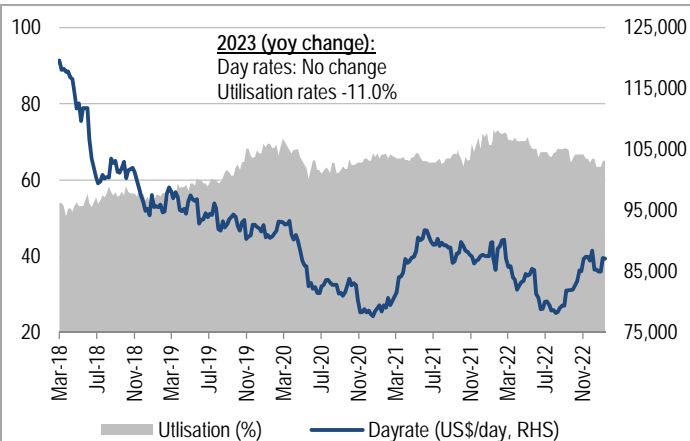
Source: Rigzone, Bloomberg

DAYRATE & UTILISATION: SEMISUB 5000-8000'



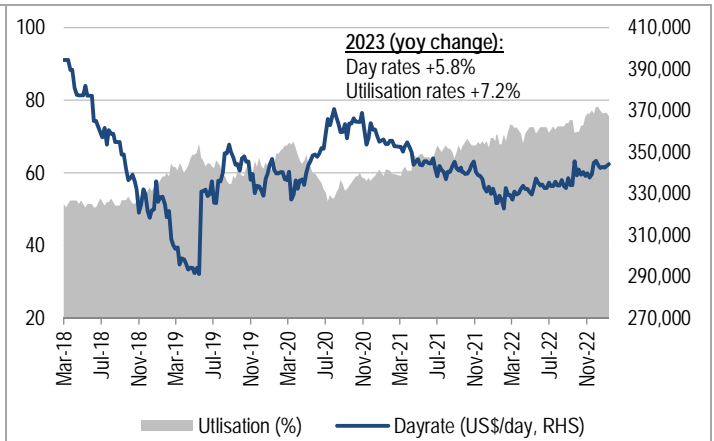
Source: Rigzone, Bloomberg

DAYRATE & UTILISATION: JACKUP 300+ IC



Source: Rigzone, Bloomberg

DAYRATE & UTILISATION: DRILLSHIP



Source: Rigzone, Bloomberg

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