Kim Heng Ltd

20 August 2021

Non-Rated
(Initiation)

Price: S$0.077 **(as at 19 Aug 2021)**

BBG	KHOM SP
Market cap	S$54.5 mil
Price (19 August 2021)	S$0.077
52-week range	S$0.027 – S$0.123
Target Price	Non-rated
Shares Outstanding	707.8 mil
Free Float	42.4 %
Major Shareholder	KH Group Holdings Pte. Ltd. (39.8%) Credence Capital Fund II (Cayman) Limited (17.7%)

P/BV (12/20)	1.0x
Net Debt to EBITDA (12/20)	n.m.

Source: Company data, Bloomberg, SAC Capital

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Moving towards a gradual recovery

Established in 1968, Kim Heng is an offshore and marine service provider, providing offshore support services such as fabrication works, installation of modules and repairs and maintenance of offshore rigs, platforms and vessels. Currently, it has 4 primary business segments: 1) Marine & Offshore related services, 2) Chartering of vessels, 3) Heavy Equipment sales and rental and 4) Renewables Energy. As the oil and gas market remains volatile and uncertain, the Group has ventured into the renewables market to pursue sustainable growth and a more reliable revenue stream. KH has plans to raise its renewables segment to 50% of total revenue (now 31%).

Catalysts for earnings growth in the next few years are:
1) Rapid growth in offshore wind energy market: Global offshore wind market is expected to grow at 31.5% CAGR in the next five year and within Asia, Taiwan being the second largest contributor to wind power installations after China, expects to increase the country offshore wind capacity to 15GW by 2035. This presents a great opportunity for KH to bag more renewables contracts in the Taiwan market. KH has horizontal directional drilling expertise, necessary for cable installation in those windfarm projects.

2) Rebound in offshore activities: US Energy Information Administration forecasts global oil consumption to reach 101.4 million b/d in 2022, 0.4 million b/d higher than pre-pandemic level in 2019. As of July 2021, Westwood Global Energy group reported an addition of 29 rigs for the year, a 6% increase from Jan 2021. This signifies restart of activities in the offshore sector and offshore services are back in demand.

3) Higher charter rates and climbing utilization rate: Clarksons Platou's North Sea historical rate for contracted AHTS showed an average spot rate of S$52,039/day in July, 89% increase m-o-m as compared to S$27,485/day in June. Assuming the same rising trend in other regions, KH is in a better position to command higher margin for its vessel charter. Vessel utilization rates are set to improve at more lucrative charter rates.

Near term concerns include 1) Competition from international big players with experience in the renewable sector and 2) Softer economic outlook brought on by Delta variant

FY ended 31 Dec	FY2016	FY2017	FY2018	FY2019	FY2020
Revenue (S$'mil)	31.4	27.4	38.1	58.1	37.6
EBIT (S$'m)	(17.0)	(13.4)	(11.1)	(4.7)	(6.9)
Net loss (S$'m)	(17.8)	(15.3)	(13.5)	(6.9)	(7.2)
EPS (S cents)	-2.5	-2.2	-1.9	-1.1	-0.7
Dividend per share (S cents)	0.07	0.07	-	-	-
Net cash / (debt)	(4.9)	(25.0)	(32.9)	(25.6)	(35.5)
Valuation					
EBIT margin (%)	-54.1	-49.0	-29.3	-8.1	-18.4
ROIC (%)	-17.3	-11.1	-13.7	-2.8	-7.1
EV/EBITDA* (x)	-5.0	-29.5	-20.5	10.8	n.m.
P/E (x)	-3.1	-3.6	-4.0	-7.0	-10.4
Dividend yield (%)	0.7	0.7	-	-	-

*Adjusted for one-off items

Investment Highlights

Rapid growth in offshore wind energy market expected in upcoming years

Global Wind Energy Council expects new wind power installations (onshore & offshore) to grow at 4% CAGR over the next 5 years from 2020-2025. Global offshore wind market is expected to grow at 31.5% CAGR in the next five year with new installations to quadruple by 2025 from 6.1GW in 2020. In total, more than 70GW offshore is expected to be added. Within Asia, China remains to be the largest contributor followed by Taiwan, Vietnam, Japan and South Korea.

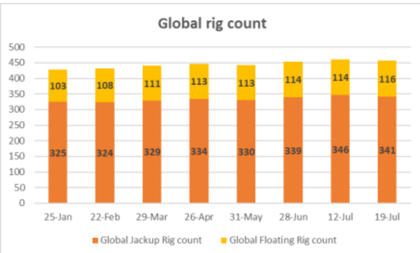
In Taiwan, the government is looking to transform the country to become a renewable energy development hub in Asia Pacific. Its goal is to phase out the use of nuclear energy and increase its energy mix for renewables to 20%. To do so, Taiwan has been aggressive on building wind energy infrastructure. It has plans to increase the country offshore wind capacity from 10GW to 15GW by 2035. Bureau of Energy within Ministry of Economic Affairs in Taiwan will release 9GW of this capacity between 2026 and 2031 in 3GW portions with applications for the first 3GW starting in second quarter of 2022 to connect to the grid in 2026-2027. Each project is capped at a maximum of 500MW and a minimum of 100MW. This points to a minimum of 30 500MW projects and a maximum of 150 100MW projects to be released over the period to 2035. Currently Taiwan's first commissioned offshore windfarm, Formosa 1 has a production capacity of 128MW with a combined total of 32 wind turbines.

This encouraging support from the Taiwanese government to advance its offshore wind market meant well for KH who ventured into Taiwan market with the help of local Taiwanese partners. Cable installation is essential to connect all wind turbines to offshore and onshore substations for electricity transmission. KH is presented with plenty of cable-laying opportunities with an approximate of 100 projects at 150MW in the pipeline. With its HDD expertise in partnership with Thaitan Drilling Company, KH is well-positioned to capture those as windfarm projects progressively kickstart. This serves as a huge potential revenue driver for KH. The Group is also looking to expand into Vietnam which is poised to become a key growing renewable market in the region.

Investment Highlights

Rebound in offshore activities

COVID-19 pandemic has brought offshore activities in 2020 to a standstill. In times of uncertainty, many companies exercised financial prudence which had led to many oil & gas projects being cancelled or delayed. However, efforts in containing the virus and increasing vaccination rate has increased the pace of global economy recovery. Oil price has since risen to highs of $80 a barrel in July 2021. US Energy Information Administration forecasts consumption of global petroleum and other liquid fuels will grow by 5.3 million b/d in 2021 and 3.7 million b/d in 2022. This would bring global oil consumption to 101.4 million b/d in 2022., 0.4 million b/d higher than pre-pandemic level in 2019. Global rig count has been steadily increasing. As of July 2021, 29 rigs has been added for the year, a 6% increase from Jan 2021. As both offshore and onshore rigs operations are expected to ramp up to cope with the oil demand, KH will still be able to profit from the O&G sector through securing more contracts.



Source: Westwood Global Energy Group

However, long term outlook for oil & gas may not be that stellar with the shift towards low carbon economy which causes structural shift in oil demand. One significant change can be observed from the increased adoption of electric vehicles which reduced the need for fuel vehicles. As most countries seeks to meet its net zero emission goal in 2050, companies are reducing its reliance on oil & gas in favor of renewable energy as an alternative source. This means a further decline in for oil demand. KH plans to increase its revenue sources from its renewable segment to 50%, reducing its reliance on the volatile oil & gas market. Shifting away from its legacy business will do good for KH in the long term, in line with the global macro trend towards decarbonization.

High charter rates and climbing utilisation rate

With the renewal of offshore activities, demand for OSV is pushing the charter rates up in 2021. Clarksons Platou's North Sea historical rate for contracted AHTS showed an average spot rate of S$52,039/day in July, 89% increase m-o-m as compared to S$27,485/day in June and 127% increase from S$22,932/day in May. Assuming rates for other regions are following the same rising trend, KH can command a higher rate for its vessels. Vessel utilisation rate is set to improve as well according to Westwood Global Energy Group. Global OSV effective utilisation is estimated at 73% in 1Q2021 and is projected to reach 86% in 3Q2023. In a bid to save on operating costs, vessel owners had stacked their idle vessels during the pandemic. As such, inclusive of stacked vessels, total utilisation in 1Q2021 stands at approximately 55%, at the same level as 1Q2020 before activities in the offshore industry were severely hit. Nevertheless, total utilisation is projected to climb to 65% by 3Q2021, influenced by growth in offshore industry.

However, as charter rate becomes more lucrative, vessel owners may redeploy and reactivate their vessels which increase the supply of OSVs in the market. This returns the imbalance in demand and supply and as a result, can progressively lead to a decline in charter rate.

Risks

Facing off with international big players within the renewable segment

Many O&M companies are pivoting towards the Renewables sector especially offshore wind sector as their existing skills are compatible and transferable to what is required in the sector. This helps to create a new sustainable source of revenue and diversify away from the cyclical oil & gas sector. Locally, well-known industry players like Keppel Offshore & Marine and Sembcorp Marine have secured and completed contracts for various windfarm projects. Sembmarine, for instance, had delivered wind farm jacket foundations for Ørsted's Hornsea 2 wind farm in the UK North Sea. Other small cap players are also making the same pivot. They include Marco Polo Marine, Penguin International and Teras Offshore. While there is an increasing number of entrants into the sector, KH is currently not in direct competition with them. KH provides cable installation services, a specific aspect in a windfarm project whereas the rest service other aspects of the project. For example, Marco Polo is involved in chartering of OSVs and fabrication of windfarm parts and Penguin International focuses on building of windfarm support vessels.

Local competition is relatively weak but it might change when others or KH decide to expand their service offerings.

On the other hand, KH faces strong competition from international big players in the same operating space such as Van Oord and Subsea 7 whereby their offshore services encompass cable installation. Van Oord was awarded the installation of the inter-array and export cables for the 900MW Greater Changhua 1 and 2a offshore wind project.

Softer economic outlook brought on by the Delta variant

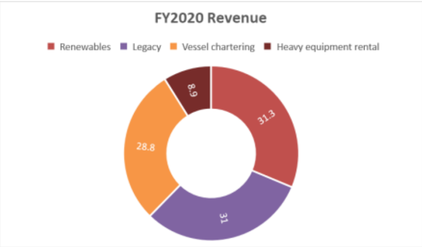
Outbreak of Delta variant are impeding global recovery with infection seen even in vaccinated persons. China for an instance has gone back to mass testing, cities lockdown and restricted domestic travel in the beginning of August, the height of summer travel season. New uptick in Delta cases was reported in at least 16 Chinese provinces including major cities such as Beijing, Shanghai and Wuhan. Fresh lockdowns slow down global economies and constrain domestic consumption. Restricted movement and activities are going to dampen fuel demand and consequently cause a slowdown in offshore activities.

Background

Listed on SGX in 2014, Kim Heng is an integrated offshore and marine value chain services provider for the oil & gas industry since 1968. KH is based in Singapore with two shipyards located at Pandan Crescent and Penjuru Road with a combined waterfront of 205 metres.

Property	Land area (sqm)	Tenure	Lease expiry
48 Penjuru Road, Singapore 609152	19,512	Lease for 30 years from 22 November 2006	22 November 2036
9 Pandan Crescent, Singapore 128465	34,125	Lease renewed for 6 years from 31 December 2015	31 December 2021*

*Management is in the process of renewing the lease.



Source: Company data

Supported by a fleet of 40 OSVs, tugs and barges, KH provides a multitude of offshore support services which include construction and fabrication works for drilling rigs and vessels, installation of offshore production modules and systems, supply of offshore drilling and production equipment and repairs and maintenance of offshore rigs, platforms and vessels etc. It also provides charter and towage service, carries out newbuilding of vessels (e.g. tugs and barges) and refurbishment of old vessels for reselling. KH also undertakes rental and sale of heavy equipment such as crawler, lorry and mobile cranes. In recent years, KH has diversified into the renewables sector to take on windfarm projects as the global scene embraced cleaner energy forms.

In 2020, renewables and legacy oil & gas both takes up 31% of KH's revenue respectively. Vessel chartering accounts for 29% while heavy lift crane and equipment rental takes up the remaining 9%.

Capturing value with distressed assets

KH has been prudently expanding its fleets since 2017 to achieve economies of scale and enjoy long term cost advantages. This is done by acquiring distressed assets during the downtimes whereby the values for these assets are severely marked down. Recent acquisition includes 2 units of AHTs bought from Posh Terasea liquidation at a significant bargain of US$4.8m in total. These distressed assets are in good working condition and require minimal refurbishment before redeployment. This allows KH to expand its fleet at a lower cost and the vessels can be reactivated to capture immediate opportunities or deploy quickly to serve other commercially viable businesses. Acquisition of vessels are co-funded by Philip Enterprise Fund Limited and Philip Ventures Enterprise Fund 5 Ltd.

Background

Ahead in the renewables with strategic partnerships

KH is involved in shallow water cable laying, a niche area under the construction phase of a windfarm project. A windfarm project has 4 general stages in its lifecycle: Planning phase, Construction phase, Operation & Maintenance phase and Decommissioning phase. The construction phase comprises many activities including the fabrication of foundation components, construction of wind turbine foundations and assembly of wind turbine components etc.

Energy generated from the wind turbine is transmitted to offshore substations to increase the voltage which prevents energy loss before it is transmitted to onshore substations for distribution purposes. As such, building a cable infrastructure network is one crucial aspect to connect the wind turbines to onshore infrastructures. To service this aspect of a windfarm project, KH had entered into a 50% joint venture with Thaitan Drilling Company Limited. Thaitan Drilling is a leading provider of Horizontal Directional Drilling (HDD) services based in Thailand. HDD is a drilling method used to drill ducts beneath the ground from which cables from the offshore wind farm can be pulled. This method causes minimal disturbance to surrounding environment due to its trenchless method which does not require excavating the ground to the depth needed for installation. KH is able to leverage on Thaitan Drilling's strong foundations in its technical capabilities and experience to complement its service offerings when bidding for windfarm projects.

KH had also entered a MOU with Hung Hua Construction Co to establish long term business cooperation. HHC is a Taiwan marine construction company involved in dredging and maritime construction projects. Through this collaboration, KH will be the preferred sub-contractor for future projects undertaken by HHC in Taiwan. HHC will also tender for future HDD projects and marine construction projects on behalf of KH.

KH is currently involved in the cable installation works for Yunlin Offshore Windfarm in Taiwan awarded by HHC. The contract has commenced in second quarter of 2020 and 6 cable conduits have since been completed. The work is estimated to be fulfilled by end of 2021.

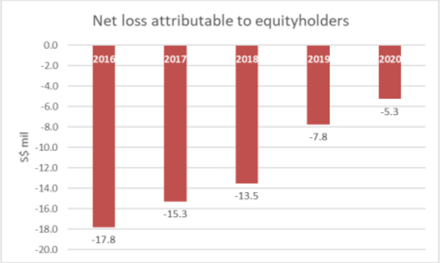
Other initiatives to transition away from O&G

KH has newly set up Zale Offshore to provide round the clock marine salvage and emergency response services targeted at oil spills and salvage accidents in Asia Pacific region. Additionally, in response to COVID-19, the Group offers vessel disinfection services in compliance with regulatory standards.

Financial summary

FY20 revenue declined as offshore activities were severely impacted by COVID-19

FY20 revenue of S$37.6m was down 35% from S$58.1m in FY19, due to project delays caused by COVID-19 pandemic. Nevertheless, pre-pandemic saw FY2019 revenue on an uptrend trajectory at 52% yoy growth from S$38.1mil to S$58.1mil, likely due to finished contracts from the renewables sector. FY20 registered positive EBITDA of S$2.7m adjusted for one-off non-cash impairment for reclassification of property at 48 Penjuru Road. KH received S$2.7m government grant for FY20.



Source: Company data

Net loss narrowed further to S$5.3m, compared to S$7.8m in FY19. Operating cash flow has maintained positive at S$3.6m albeit 26% lower than FY2019 (S$4.9m).

Improved topline in 1H21

Revenue for first half registered $28.9m, a 64% jump from S$17.7m in 1H20. All segments shown gains. O&G activities have undoubtedly returned, although operations still lagged slightly behind 2019's level. (1H19: S$32.7m) Chartering segment has significantly improved the Group's topline. Its first half revenue for the segment outpaced total revenue for FY2019 by S$2.5m, credited to higher daily charter and utilization rates. Marine offshore segment has also made positive progress. The segment delivered S$13.0m in 1H revenue which represented a 52.4% increase yoy. 1H revenue results showed promising recovery in O&G sector and provided an optimistic outlook for 2H21 which continues to be supported by high charter and utilization rates and renewed offshore activities. EBITDA has remained positive at S$1.8m. Operating cash flow turned negative due to higher working capital. KH incurred a net loss of S$3.6m in 1H21.

Gearing remains unchanged

Net gearing ratio stood at 62% as at 30 June 2021 (Dec 2020: 60%) with net debt at S$35.3m (Dec 2020: S$35.5m). There was a reclassification of S$6.2m loan from non-current to current liabilities as a result of a breach in loan covenant. Consequently net current liabilities rose to S$12.1m. The Group has since obtained an indulgence waiver letter from the financial institution. To enhance its liquidity position, the Group has obtained a new banking facility of S$5m to service its working capital and has plans to dispose vessels that do not contribute to future growth.

Comparables

The companies selected provide mainly various offshore marine services and chartering services. Both derive their revenue from the O&G sector and have not ventured into the renewables market. We do not expect the offshore sector to return to profitability in the short term.

Name	YE	Mkt Cap	Revenue (S$ mil)	EBITDA (S$ mil)	EBIT (S$ mil)	Net profit	EBIT margin %	Net margin %	ROE %	ROIC %	EV/EBITDA (x)	EBIT/EV %	PER (x)	PBR (x)
Kim Heng (BBG: KHOM)	12/20	54.6	37.6	0.004	-6.9	-7.2	-18.4	-19.1	-12.9	-7.1	143.7	-7.7	-7.6	1.0
Atlantic Navigation (BBG: ATL)	12/20	24.1	87.6	10.9	-0.8	-7.4	-0.9	-8.5	-6.7	-1.5	10.2	-0.7	-4.4	0.3
CH Offshore (BBG: CHO)	12/20	49.3	25.7	-18.1	-26.4	-26.4	-102.4	-102.7	-34.2	-32.0	-4.3	-34.1	-2.5	0.9
											Average:	-17.4	-3.5	0.6

Source: Companies' Annual reports
USD/SGD =1.35

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