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Sembcorp Marine extends gradual slide with weak Q3 results

by XIA Xinyao

Sembcorp Marine (SMM), the world's second largest oil rig builder, delivered its worst quarterly performance since Q4 of 2007 as Q3 earnings plunged 76% YoY to USD 23.1mn. The company is battling headwinds from various fronts, including low oil prices and an oversupplied global offshore exploration sector. The RMI-CRI 1-year Probability of Default (PD) for SMM (shown in Figure 1) has been on an uptrend, in tandem with the slump in oil prices since July last year.

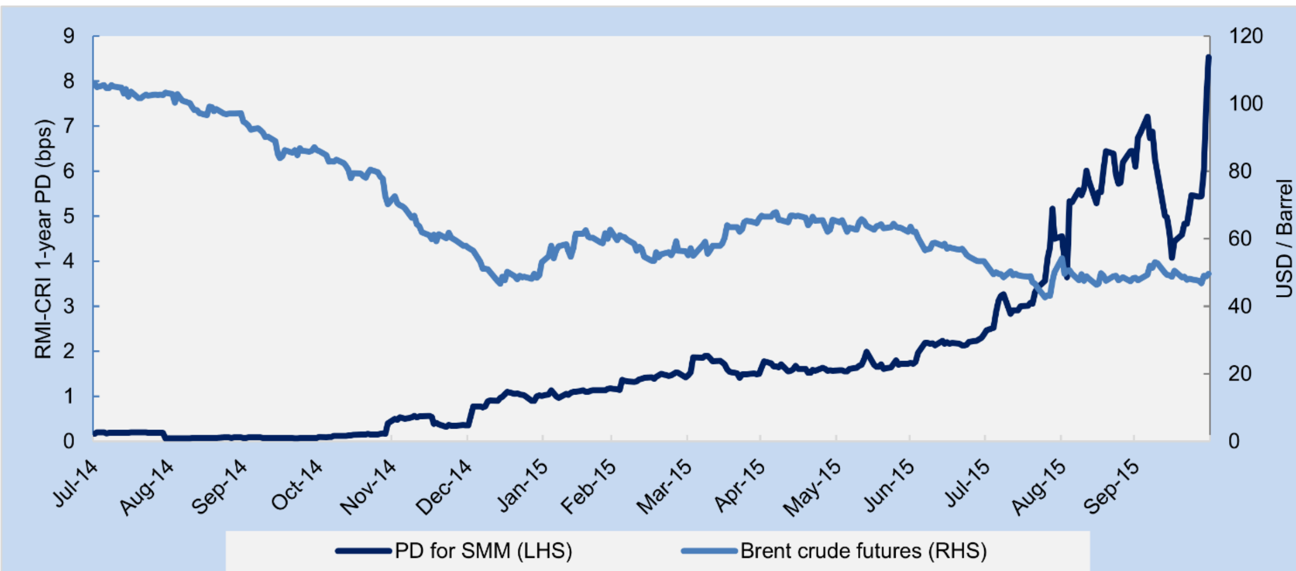

Figure 1: RMI-CRI 1-year PD for SMM and Brent crude futures price. *Source: RMI-CRI, Bloomberg*

Sembcorp's business is made up of three major sectors: Rigs & Floaters (68%), Repairs & Upgrades (11%), and Offshore Platforms (20%). More than half of the firm's sales comes from building rigs and floaters, which makes the company highly prone to developments in the oil and gas industry. In fact, the sizable fall in overall Q3 sales was mainly due to a 43.4% plunge in revenue in the Rig & Floaters segment and a 16.5% fall in the Repair & Upgrades segment.

As a result of persistently low oil prices, many of SMM's clients have reduced oil exploration activity and capital expenditures, leading to a lack of new charter contracts and cancellation of existing charters. Turnover for Rigs & Floaters was USD 2.5bn for the nine months to September 2015, a 21% decline from the USD 3.1bn booked in the previous corresponding period. The Group delivered three rigs in the nine months, compared with six rigs in the previous corresponding period. Customer's deferment requests have also resulted in lower margin recognition for rig building projects.

	Q3 2014	Q4 2014	Q1 2015	Q2 2015	Q3 2015
Cash & Cash Equivalents (USD mn)	1,221.60	812.9	820.4	608.7	580.6
Net Income (USD mn)	105.5	134.3	78.0	81.3	23.1
Net Debt/Equity (%)	3.06	21.22	27.63	50.95	63.88

Table 1: Net income and balance sheet variables. *Source: Bloomberg*

Table 1 shows that the cash & cash equivalents of Sembcorp has been on a decline. The proportion of net debt to equity has weakened significantly due to a net debt position of USD 1.42bn at the end of September, which has increased from USD 70mn in Q3 2014. The trend of continued negative free cash flow and accumulation of more debt on the balance sheet is likely to further drain the cash position of the company, deteriorating its liquidity.

Despite the present headwinds, Sembcorp Marine has secured USD 2.1bn in new contracts so far in 2015 in the offshore production market segment, bringing its net order book total to USD 8.3bn. The firm may have to sell assets to maintain a healthy financial position, but we might not see a material decline in creditworthiness in the short term. The company is restructuring its business units to improve work efficiency and optimize operating capabilities. Although the increase in the RMI-CRI 1-year PD was many folds, the current level still indicates a fairly low credit risk.

Credit News

DBS third-quarter profit beats estimates on interest income

Nov 2. DBS posted a 6% gain in Q3 profit as interest margins at a 4-year high boosted net interest income to a record. Additionally, the bank also reported an increase in net income to SGD 1.07bn for the 3 months ended Sep 30 from SGD 1.01bn last year. Also, DBS managed to grow its loans by 9% in the September quarter, largely due to currency effects. The bank reduced its exposure to high-cost deposits and its net interest margin rose by 10bps to 1.78% from a year ago, and from 1.75% in the previous quarter. Furthermore, the increase in the 3-month Singapore interbank offered rate has also helped to support the bank's high interest rate margins this year. (Bloomberg)

Euro Banks barely cut bad debt levels under ECB

Nov 2. Euro-area banks have only narrowly cut down their bad loans since the ECB began to supervise them last year. The volume of their non-performing loans (NPL) fell only 1.8% to EUR 826bn since the end of 2013, the reference date for the ECB's comprehensive balance sheet assessment. As a share of total assets, NPLs declined to 3.92% from 4.13% in this period. This persistence of bad debt overhang in Euro-area banks is caused by several factors, such as poor global economic conditions, poor banking practices, as well as legal frameworks for debt recovery. (Bloomberg)

Interest rate deregulation dents China bank profits

Nov 1. The latest Q3 result shows that profits at China's four largest banks were adversely affected due to shrinking interest margins and increasing bad loans. Net interest margins are shrinking as China completes its interest rate deregulation. Additionally, the Chinese Central Bank also announced that it was eliminating the longstanding cap on deposit rates. The move followed a gradual loosening of the cap over the past two years. Bad loans are also rising in China's banks as the economy slows down, especially when China's manufacturing sector struggles with overcapacity and declining prices. Overall, last week's release of Q3 results on China's banks highlighted that the era of easy profits is coming to an end. (FT)

Taiwan's economy shrinks for first time since 2009 on export slump

Oct 30. Taiwan's economy dropped by 1.01% YoY in Q3, contracting for the first time since the global financial crisis due to a slump in exports and a sluggish global recovery. Taiwan's exports are sliding as economic growth in the top destination of China slowed further to a six-year low. This also started to curb domestic consumption last quarter, which marked the biggest slide for local shares since 2011 amid the yuan's shock devaluation in August. However, economists say growth is likely to recover in Q4 as US and Chinese demand recovers, limiting room for another rate cut this year in December. (Bloomberg)

Bank of China's bad-loan buffers weaken as profits declines

Oct 29. Bank of China's profit fell in the third quarter for the first time since the global financial crisis while China Construction Bank reported little-changed earnings as a slowing economy adds pressure on lenders' balance sheets. The results for two of China's four biggest banks showed the mounting strain from bad loans in a cooling economy. While both set aside record extra provisions in the quarter for soured credit, their bad-loan coverage ratios fell, signaling a drag on future profits because of the need to set aside additional reserves. (Bloomberg)

Starbucks' forecast misses estimates after labor costs climb (Bloomberg)

US natural gas crashes to lowest level since 2012 (FT)

China slowdown hits Africa growth (FT)

Regulatory Updates

US banks to face USD 120bn shortfall in Fed crisis plan

Oct 31. The largest US banks would face a USD 120bn total shortfall of long-term debt under a Federal Reserve proposal aimed at ensuring their failure wouldn't hurt the broader financial system. Banks such as Wells Fargo & Co. and JPMorgan Chase & Co. will be required to hold enough debt that could be converted into equity if they were to falter. The Fed's proposal, which applies to eight of the biggest US banks, requires debt and a capital cushion equal to at least 16% of risk-weighted assets by 2019 and 18% by 2022. (Bloomberg)

Crowdfunding allowing Internet stock sales approved by SEC

Oct 30. Startups and other small businesses will be free to raise money by selling stock over the Internet under new rules adopted by the US Securities and Exchange Commission. The new equity crowdfunding standards lay out how such firms can raise as much as USD 1mn annually by offering shares to investors online. It took the SEC more than three years to adapt the concept to securities markets, as regulators struggled to balance demands for fewer requirements with warnings about potential frauds. (Bloomberg)

US banks hit out at collateral rules on derivatives trade

Oct 28. Banks are reeling after rules finalized by US regulators, aimed at reducing the risk of trading esoteric derivatives, are set to increase trading costs and further hit the deteriorating fixed income business. The Federal Deposit Insurance Corporation (FDIC) will require banks to post and receive collateral to protect against losses on derivatives that are traded bilaterally. Banks will also have to collect collateral on trades done with their own affiliates, but here the burden has been eased a little as the FDIC's proposed rules required inter-affiliate trades to both collect and post collateral. (FT)

FCA flags concerns on some credit card debt (FT)

George Osborne unveils curbs on buy-to-let mortgages (Telegraph)

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