Update

2 July 2009

Hallin Marine Subsea International

Year End	Revenue ($m)	PBT* ($m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/07	64.8	11.2	25.1	2.0	9.8	0.9
12/08	139.9	35.4	77.6	3.7	3.2	1.8
12/09e	133.0	18.3	35.7	3.0	4.7	1.8
12/10e	147.0	19.7	39.0	3.0	4.3	1.8

Note: *PBT and EPS are normalised, excluding goodwill amortisation and exceptional items. Valuation assumes average rates historically and £1.00/$1.50 in 2009.

Investment summary: Falling market

Hallin yesterday announced that increased competition has caused a narrowing of margins and lower utilisation rates for non-specialist assets. None of Hallin's orders have been deferred or cancelled, but order books have been slower to build up than anticipated and demand for engineering services has been muted. We are cutting our 2009 forecast revenues by $23m (15%) and underlying EBIT by $5.7m (22%). We release our 2010 numbers with profits returning to growth (4% operating profit y-o-y) as older assets are replaced by newer higher margin assets which are still seeing strong demand.

Oversupply and project deferrals at peers

The 2009 weakness stems from project deferrals at competitors increasing the availability of dive support ships and new ships coming online especially at the lower-value end. These effects have led to charge out rate pressure and are particularly apparent in the company's Eastern division. While Hallin continues to see projects on which to bid, average bid rates in the Eastern division are c 20% down compared to 2008 and overall utilisation is down by c 10%. This spurred Hallin to terminate the charter of a lower-end vessel which has seen the brunt of demand weakness. The Western division has fared better with rates generally maintained for ROV support, but lower-value equipment-only rates are weaker. The Prospect engineering division is also seeing a general reduction in demand, especially for new construction projects.

Asset mix strategy reduces operational gearing

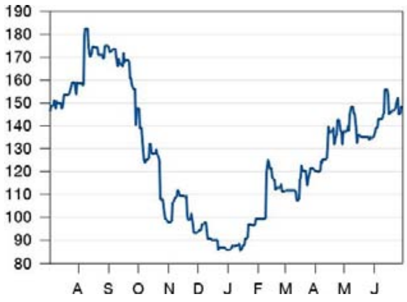
Hallin's strategy of using a mix of owned, long-lease and short-lease assets is expected to reduce the effect on profits. Management has already cancelled the lease on one asset and we have a termination fee of c $750k in our numbers saving c $1.5m charter costs in 2009. Hallin now has no spot charter dive support vessels.

Valuation: Mid-sector multiples

Following the announcement, Hallin's shares dropped 25% to 113p. On our new 2010e numbers, Hallin is trading at normalised P/E of 4.3x.

Price	113p
Market Cap	£47m

Share price graph



Share details

Code	HMS
Listing	AIM
Sector	Oil & Gas
Shares in issue	41.3m

Price

52 week	High	Low
	145p	105p

Balance Sheet as at 31 December 2008

Debt/Equity (%)	28.1
NAV per share (p)	157
Net borrowings ($m)	19.6m

Business

Hallin Marine is an oilfield services group based in Singapore. It specialises in the installation, repair and maintenance of subsea installations for the oil and gas industry; subsea vessel and ROV leasing; and engineering services.

Valuation

	2008	2009e	2010e
P/E relative	31%	56%	59%
P/CF	2.0	3.5	2.1
EV/Sales	0.9	0.9	0.7
ROE	50%	20%	18%

Revenues by geography

UK	Europe	US	Other
25%	0%	14%	61%

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Hallin Marine Subsea International is a research client of Edison Investment Research Limited

Scaling back on weaker demand

Hallin has again grown profits for the last three years. We expect a retrenchment in 2009 as delayed investment in the oil industry slackens demand and the tail of new supply is released into the market. As we stated in our last note, the offshore services industry finds itself at a crucial point with the apparent overheating of the past two years unwinding. We now believe Hallin will not escape the general sector weakness as prices for its vessels face pressure from lower grade competition. While management has taken steps to readjust its asset base to protect margins, it cannot buck the trend of top line contraction. Therefore we have reduced our 2009 sales estimates by $23m to $133m, operating profit by $5.7m to $20.3m and EPS by 15c to 35.7c.

Slight profit growth expected in 2010

The fundamentals of the shallow offshore oil services industry remain robust in our view and we expect a stabilisation in 2010 once the oversupply has worked through the industry. We now model charge-out rates 40% lower for the most basic vessels and c 10% lower for more advanced vessels despite demand currently remaining strong. We keep rates flat for high value adding dive support and ROV vessels. In 2010, we expect competitive pressure to continue to grow for lower-spec vessels. Hallin is expected to take delivery of its second owned vessel, the Windermere, in H2 of 2009 which is high specification and hits a sector still seeing strong demand. Its sister ship, the Ullswater, remains at full utilisation. The new vessel will replace some of Hallin's older leased vessels which it has handed back and should stabilise revenues. As the new vessels operate at higher margin, profits should continue to see a slight increase.

Lower profit expected from system sales

The saturated diving system Hallin intends to sell in 2009 is smaller than those previously sold and we expect a profit on disposal of around $2m. This is a fall from 2008 when Hallin was able to sell two larger systems for a total profit of $7.5m.

Finances remain strong: We release our 2010 numbers

We expect a return to growth in 2010 as Hallin's readjusted asset base focuses on its core higher-value end dive vessels and ROVs which continue to see good demand and higher margins. The Prospect engineering division is also expanding into Asia despite subdued demand in current markets. We forecast sales of $147m and operating profits of $22.7m, still up c 11% on our lower 2009 number.

We expect gearing to fall from 43% in 2009 to 26% in 2010 based on our assumption that Hallin does not commission work for its third vessel in 2010 returning the company to cash generation of $10m. Management has previously stated 50% as an optimal gearing indicating room for further investment. We believe the dividend will likely remain at 2p while the company continues to look for growth opportunities. Weaker sterling means the dividend is a lower cash burden and cover should remain good at around 13x.

Exhibit 1: Financials

Year end 31 December	$'000s	2005	2006	2007	2008	2009e	2010e
Accounting basis		IAS	IAS	IAS	IAS	IAS	IAS
PROFIT & LOSS							
Revenue		26,566	38,865	64,754	139,898	133,000	147,000
Cost of Sales		(21,542)	(32,989)	(45,560)	(92,159)	(94,700)	(104,931)
Gross Profit (after depreciation)		5,024	5,876	19,194	47,739	38,300	42,069
EBITDA		2,941	1,320	14,827	40,834	25,300	27,569
Operating Profit (before GW and except.)		2,451	3,778	11,852	36,676	20,300	22,569
Goodwill Amortisation		0	0	0	0	0	0
Exceptionals		0	0	0	0	3,300	0
Other		(39)	440	0	0	0	0
Operating Profit		2,412	4,218	11,852	36,676	23,600	22,569
Net Interest		(105)	(43)	(652)	(1,278)	(2,000)	(2,600)
Profit Before Tax (norm)		2,307	4,174	11,200	35,398	18,300	19,969
Profit Before Tax (FRS 3)		2,307	4,174	11,200	35,398	21,600	19,969
Tax		(52)	(278)	(1,159)	(3,922)	(2,745)	(2,995)
Profit After Tax (norm)		2,255	3,896	10,041	31,476	15,555	16,974
Profit After Tax (FRS3)		2,255	3,896	10,041	31,476	18,855	16,974
Average Number of Shares Outstanding (m)		28.7	37.0	40.0	40.6	43.6	43.6
EPS - normalised (c)		7.8	10.5	25.1	77.6	35.7	39.0
EPS - normalised fully diluted (c)		7.8	10.5	23.7	72.2	35.7	39.0
EPS - FRS 3 (c)		7.8	10.5	25.1	77.6	43.3	39.0
Dividend per share (c)		1.7	1.9	2.0	3.7	3.0	3.0
Gross Margin (%)		18.9%	15.1%	29.6%	34.1%	28.8%	28.6%
EBITDA Margin (%)		11.1%	3.4%	22.9%	29.2%	19.0%	18.8%
Operating Margin (before GW and except.) (%)		9.2%	9.7%	18.3%	26.2%	15.3%	15.4%
BALANCE SHEET							
Fixed Assets		7,423	32,727	66,353	105,529	121,985	120,985
Intangible Assets		0	0	0	7,583	0	0
Tangible Assets		5,621	31,186	64,638	97,585	121,985	120,985
Assets held for sale		1,801	1,541	1,715	361	0	0
Current Assets		9,192	18,349	28,343	53,093	63,012	63,013
Work in progress			913	0	0	3,000	3,000
Debtors		7,279	15,067	20,390	30,081	37,000	37,001
Cash		1,913	2,370	7,953	23,012	23,012	23,012
Current Liabilities		(7,096)	(14,620)	(36,285)	(73,715)	(72,914)	(69,439)
Creditors		(6,267)	(10,805)	(33,102)	(53,031)	(52,230)	(48,755)
Short term borrowings		(830)	(3,815)	(3,183)	(20,684)	(20,684)	(20,684)
Long Term Liabilities		(332)	(12,185)	(24,711)	(21,977)	(32,727)	(20,659)
Long term borrowings		(324)	(12,147)	(24,668)	(21,977)	(32,727)	(20,659)
Other long term liabilities		(7)	(38)	(43)	0	0	0
Net Assets		9,187	24,271	33,700	62,930	79,356	93,900
CASH FLOW							
Operating Cash Flow		(1,830)	2,081	30,384	41,665	21,300	23,569
Net Interest		(234)	(102)	(652)	(1,278)	(2,000)	(2,600)
Tax		(17)	(140)	(574)	(3,120)	(2,745)	(2,995)
Capex		(4,070)	(26,181)	(33,048)	(36,111)	(29,400)	(4,000)
Acquisitions/disposals		0	0	0	0	0	0
Financing		4,849	10,570	(1,616)	(111)	4,000	0
Dividends		0	(580)	(800)	(796)	(1,905)	(1,905)
Net Cash Flow		(1,302)	(14,351)	(6,306)	249	(10,750)	12,068
Opening net debt/(cash)		(2,100)	(759)	13,592	19,898	19,649	30,399
HP finance leases initiated		0	0	0	0	0	0
Closing net debt/(cash)		(798)	13,592	19,898	19,649	30,399	18,331

Source: Edison Investment Research