midf RESEARCH

08 August 2018 | 2QFY18 Results Review

MISC Berhad

Tonnage Oversupply Remains a Drag

Maintain NEUTRAL

Reduced Target Price (TP): RM6.01

(Previously: RM6.11)

INVESTMENT HIGHLIGHTS

- **1HFY18 earnings below expectations**
- **Tonnage oversupply remains a risk for LNG segment**
- **Petroleum segment impacted by higher opex**
- **Heavy engineering remains challenging**
- **Maintain NEUTRAL with reduced TP of RM6.01 per share**

1HFY18 results below expectations. MISC reported a normalised PATAMI of approximately RM698.4m in 1HFY18 which is -47.8%yoy lower and is below ours and consensus estimates by a variance of more than >10%. The deviation came from increased bunker charges and higher conversion costs from the heavy engineering segment.

Lower number of operating LNG vessels. The revenue and PBT of the LNG segment in 1HFY18 both declined by -10.9%yoy and -35.2%yoy respectively. Profitability in the segment was hampered by; (i) the impairment of receivables from Yemen LNG as per MFRS 9; (ii) the absence of compensation for termination of Tenaga Lima and; (iii) the lower charter rates for the Seri C class vessels compared to the Puteri class vessels.

Overcapacity remains a problem. LNG spot rates in 2QFY18 were +70%yoy higher amidst strong LNG demand from China which imported 4.2m tonnes of LNG in May 2018, 42.8% higher year-on-year. We reckon that impact of China's proposed 24% tariff on U.S LNG imports to be minimal as U.S imports only make up roughly 3.0% of total LNG imports of China. Notwithstanding this, the number of newbuilds delivery in 1HFY18 has already surpassed FY2017, causing risk of excess capacity even after considering China's growing LNG demand. Moreover, the total expected delivery of vessels in FY18 is approximately 50% more than in the previous year which could partially cater the demand from China. As such, LNG spot rates will remain under pressure in the coming quarters, dampening earnings prospects of this segment.

Losses for petroleum segment widened The petroleum segment recorded a loss before tax for the fifth consecutive quarter amidst depressed charter rates hitting the lowest since 2014 combined with higher operating expense.

RETURN STATS	
Price (7th August 2018)	RM6.46
Target Price	RM6.01
Expected Share Price Return	-7.0%
Expected Dividend Yield	+4.6%
Expected Total Return	**-2.4%**

STOCK INFO	
KLCI	1,791.09
Bursa / Bloomberg	3816 / MISC MK
Board / Sector	Main / Trading Services
Syariah Compliant	Yes
Issued shares (mil)	4,463.8
Market cap. (RM'm)	28,836.10
Price over NA	0.83
52-wk price Range	RM5.03 - RM7.90
Beta (against KLCI)	0.92
3-mth Avg Daily Vol	2.49m
3-mth Avg Daily Value	RM15.4m
Major Shareholders (%)	
Petronas	62.67
PNB	7.15
EPF	5.93

Although scrapping activities reached a five-year high in 2QFY18, this has yet to match the oversupply of tankers in the market. However, we reckon that higher term to spot ratio of 59:41 in 2QFY18 compared to 49:51 in 2QFY17 for its petroleum vessels acts as a sustainability factor for the segment.

Contract extensions support FSO division. The offshore segment recorded a -32.7%yoy decline in PBT in 1HFY18 as the contract extension of FSO Orkid was offset: (i) by lower construction revenue from FSO Benchamas 2 and; (ii) the absence of the gain from the GKL adjudication seen in 1HFY17. Moving forward, MISC's long term charter contract with HESS for the lease of FSO Mekar Bergading commencing in 3QFY18 with estimated additional revenue of RM110m per year and the highly possible extension of FPSO Ruby 2 may outweigh the non-renewals of FSO Puteri Dulang and FSO Angsi.

Challenging outlook for heavy engineering. Despite crude oil prices and the overall operating climate improving, FY18 will continue to be a challenging year for the heavy engineering segment. This is predominantly due to the timing differences in revenue and profit recognition between tail-end projects and new projects. The large portion of its orderbook consists of the RM1b Bokor CPP job which will only undergo the first steel cut in 3QFY18 – the large portion of works will happen only in FY19. Overall segment contribution is less than 10% of total group profit.

Earnings impact. Taking into consideration: (i) ongoing risk of tonnage oversupply in the LNG and petroleum division that may put charter rates under pressure and; (ii) higher depreciation from incoming petroleum vessels, we are revising our earnings downwards our earnings forecast for FY18 and FY19 to RM1.57b and RM1.79b, respectively

Maintain NEUTRAL with reduced TP of RM6.01 per share (previously RM6.11 per share) pegged to 0.74x price-to-book value representing a discount of -2.5(previously -1.0) standard deviation below its five-year average to reflect the persisting trend of lower charter rates amid tonnage oversupply. Our neutral stance is predicated on: (i) timing differences in revenue recognition of tail end and new projects for the heavy engineering segment; (ii) contract renewal risk for its FSO projects and; (iii) low demolition in the LNG shipping space. This could be offset by MISC Berhad's strategic term-to-spot ratio for its petroleum vessels coupled with its chemical tankers being injected into a pool to optimise utilisation.

Figure 1: LNG tanker rates (US$'000/day)

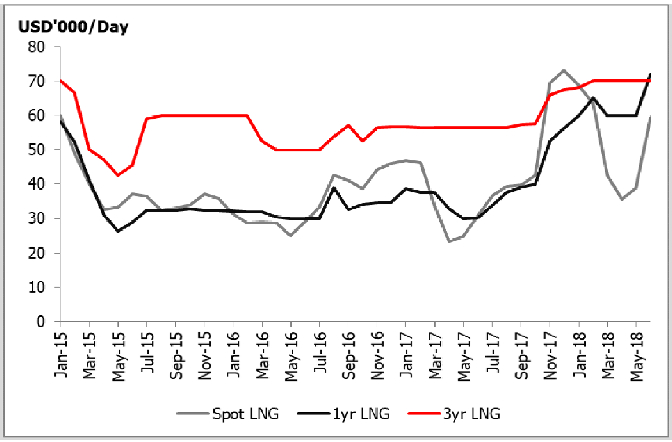
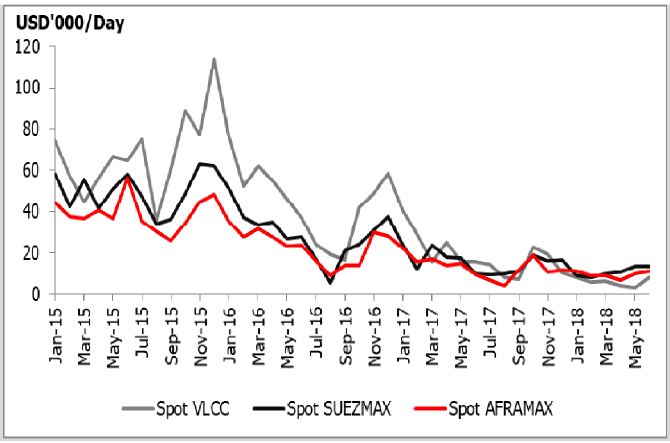


Figure 2: Spot Petroleum tanker rates (US$'000/day)



Source: Company, Ship Brokers' Reports, MIDFR

INVESTMENT STATISTICS

FYE Dec	FY15	FY16	FY17	FY18F	FY19F
Revenue (RM' m)	10,908.4	9,597.2	10,068.2	8,800.0	9,363.1
EBIT (RM' m)	2,746.9	3,011.6	2,172.1	1,794.6	1,979.2
Pretax Profit (RM' m)	2,566.9	2,814.0	2,003.6	1,575.1	1,801.2
Net Profit (RM' m)	2,513.9	2,793.3	1,990.7	1,565.7	1,790.4
Normalised Profit (RM'm)	3,085.1	1,883.0	2,788.9	1,565.7	1,790.4
EPS (sen)	69.4	42.2	62.5	35.1	40.1
EPS growth (%)	75.4	-39.2	48.1	-21.3	14.4
PER (x)	9.3	15.3	10.3	18.4	16.1
Net Dividend (sen)	30.0	30.0	30.0	30.0	30.0
Net Dividend Yield (%)	4.6	4.6	4.6	4.6	4.6

Source: MIDFR, Company

DAILY PRICE CHART

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Source: Bloomberg

MISC: 1HFY18 RESULTS SUMMARY

All in RM'm unless stated otherwise	Quarterly Results			Cumulative		Comments
FYE Dec	***2QFY18***	***%YoY***	***%QoQ***	***1HFY18***	***%YoY***	
Revenue	2,141.8	-7.0	6.0	4,162.6	-21.3	Lower number of operating vessels
COGS	(1,623.4)	0.9	11.5	(3,080.0)	-11.8	
Gross profit	518.4	-25.2	-8.1	1,082.6	-39.7	
Other income	51.2	-78.7	-22.2	117.0	-61.3	
SG&A	(222.6)	3.1	-9.7	(469.2)	-32.8	
Operating profit	347.0	-51.6	-9.5	730.4	-47.8	
Finance Cost	(99.5)	52.8	31.4	(175.2)	33.8	
Asso. & JV Contribution	70.0	17.4	455.6	82.6	-24.8	
Exceptional gain/(loss)	1.0	100.7	190.9	(0.1)	-99.9	
Profit before tax	318.5	-43.0	-0.2	637.7	-49.2	
Tax expense	(9.3)	89.8	-8.8	(19.5)	156.6	
PATAMI	309.2	-44.2	0.1	618.2	-49.7	
Normalised PATAMI	368.8	-20.2	11.2	700.4	-47.8	Add back impairment loss on receivables

OPERATING SUMMARY (USD'm)

Segmental Revenue	***2QFY18***	***%YoY***	***%QoQ***	***1HFY18***	***%YoY***	***Comments***
LNG	150.9	-10.4	1.3	299.8	-10.9	
Petroleum	255.4	7.6	2.7	504.1	-4.2	
Offshore	73.2	-0.9	-2.5	148.3	-38.0	Lower revenue from FSO Benchamas 2
Heavy Engineering	58.9	-0.7	28.6	104.7	-6.8	Completion of projects
Total	538.4	-0.1	3.8	1056.9	-12.9	
Segmental PBT	***2QFY18***	***%YoY***	***%QoQ***	***1HFY18***	***%YoY***	***Comments***
LNG	58.8	-51.4	-10.0	124.1	-35.2	Tonnage oversupply
Petroleum	-24.1	-153.7	-31.0	-42.5	-1471	Higher opex
Offshore	46.6	5.7	43.8	79	-32.7	Lower revenue from FSO Benchamas 2
Heavy Engineering	-11.8	-280.6	-78.8	-18.4	-159.2	Completion of projects
Total	69.5	-54.3	-4.4	142.2	-53.3	

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <-10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.