midf RESEARCH

21 November 2018 | 3QFY18 Results Review

MISC Berhad

Winter demand kicks in

Maintain NEUTRAL

Revised Target Price (TP): RM6.33

(Previously: RM6.01)

INVESTMENT HIGHLIGHTS

- **9MFY18 earnings below expectations, impacted mainly by higher finance cost for the three Seri C class vessels**
- **Higher dry-docking days lead to lower LNG earnings**
- **Expecting a recovery in the offshore segment with the charter of FSO Mekar Bergading and FSO Benchamas 2**
- **Near-term outlook for the heavy engineering segment remains challenging**
- **Maintain NEUTRAL with revised TP of RM6.33 per share**

9MFY18 results below expectations. MISC reported 3QFY18 normalised PATAMI of RM314.1m (-61.8%yoy), bringing its 9MFY18 normalised PATAMI to RM1.02b (-52.9%yoy). This was below ours and consensus' FY18 earnings estimates by a variance of more than five percent. The deviation mainly came from the higher finance costs due to the loan drawdown for the three Seri C class vessels that were received this year.

Weak LNG segmental earnings amidst late surge in spot rates. 3QFY18 revenue and PBT of the LNG segment declined by -7.7%yoy and -41.2%yoy respectively. Profitability in the segment was hampered by; (i) higher dry-docking days for vessels of 200 days for the quarter compared to 150 days a year ago; and (ii) the lower charter rates renewed for Puteri Intan Satu.

LNG spot rates to remain resilient in 4QFY18. While the LNG spot rates rose +96%yoy in 3QFY18, the rise only occurred towards end of the quarter and therefore, the impact was minimal to lift earnings. In the immediate term, availability of vessels combined will become more tightened in addition to early winter demand in 4QFY18. Beyond that, seaborne LNG demand is expected to increase about 8%yoy in 2019 according to Clarksons. This will be propelled by Chinese demand which will provide support to LNG spot rates.

Plans to venture into non-conventional LNG activities. Following the surge in spot rates, the company plans to unlock value up to three vessels in the spot market by venturing into non-conventional LNG shipping solutions. This may include feeder services, bunkering and floating storage unit (FSU).

RETURN STATS	
Price (19th November 2018)	RM6.60
Target Price	RM6.33
Expected Share Price Return	-4.1%
Expected Dividend Yield	+4.5%
Expected Total Return	**+0.4%**

STOCK INFO	
KLCI	1,710.71
Bursa / Bloomberg	3816 / MISC MK
Board / Sector	Main / Trading Services
Syariah Compliant	Yes
Issued shares (mil)	4,463.8
Market cap. (RM'm)	29,460.72
Price over NA	0.85
52-wk price Range	RM5.03 - RM7.90
Beta (against KLCI)	0.89
3-mth Avg Daily Vol	1.45m
3-mth Avg Daily Value	RM9.02m
Major Shareholders (%)	
Petronas	62.67
PNB	9.30
EPF	6.10

Losses for petroleum segment narrowed. The petroleum segment recorded a loss before tax for the sixth consecutive quarter, albeit slower pace, amidst higher freight rates for Aframax and Suezmax vessels. The strength in freight rates were buttressed by scrapping activities as of end 3QFY18 which was almost 1.8x of FY17. We reckon that tanker rates in 4QFY18 will be higher than the previous three quarters due to the peak winter season but will not surpass 2015 peak levels. The reason being is that scrapping activities has yet to match the order book for deliveries that are still sizeable up to end 2019 before tapering in 2020. In the long run, charter rates would be underpinned by movement of oil from the Atlantic to Asia, boosting growth in tonne mile which bodes well for MISC's higher term to spot ratio of 59:41 in 3QFY18 compared to 47:53 in 3QFY17.

FSO Benchamas 2 and FSO Mekar Bergading to support the FSO division. The offshore segment recorded a -35.3%yoy decline in PBT in 3QFY18 due to the absence of: (i) construction revenue from FSO Benchamas 2 and; (ii) the gain from the GKL adjudication seen in August 2017. This was partially offset by the commencement of FSO Mekar Bergading. Moving forward, we expect the segment's earnings growth will come from the full year contribution from FSO Benchamas 2 and MISC's long term charter contract, bearing an estimated annual revenue of RM200m, with HESS for the lease of FSO Mekar Bergading. These new assets serve as a buffer for the expiry of FSO Puteri Dulang in 1QFY21 which has no commercial plans to be extended.

Near-term outlook for heavy engineering remains challenging. The heavy engineering segment posted its third consecutive quarter of losses in 3QFY18. We do not expect the outlook to improve in view of the timing differences in revenue and profit recognition between tail-end projects and new projects. The large portion of its order book consists of the RM1b Bokor CPP job which underwent the first steel cut in 3QFY18, with the bulk of the activities to take place only in FY19. However, its Marine segment could potentially benefit from increased in marine repair activities in the coming year due to the impending compliance to the International Maritime Organisation (IMO) fuel sulphur cap ruling by January 2020. Overall segment contribution is expected to be less than 10% of total group profit.

Earnings estimates. We are maintaining our revenue estimates for the respective business segments of MISC as we have factored in the seasonal effects. Meanwhile, we have imputed a higher finance cost estimate to reflect the borrowings for the three Seri C class LNG vessels. Therefore, we are revising downwards our earnings forecast for FY18 and FY19 to RM1.39b and RM1.62b, respectively.

Maintain NEUTRAL with revised TP of RM6.33 per share (previously RM6.01 per share) pegged to 0.80x price-to-book value representing a discount of -1.5 (previously -2.5) standard deviation below its five-year average to reflect the buoyant market condition moving forward. 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) sizeable deliveries that may outweigh scrapping activities. 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)

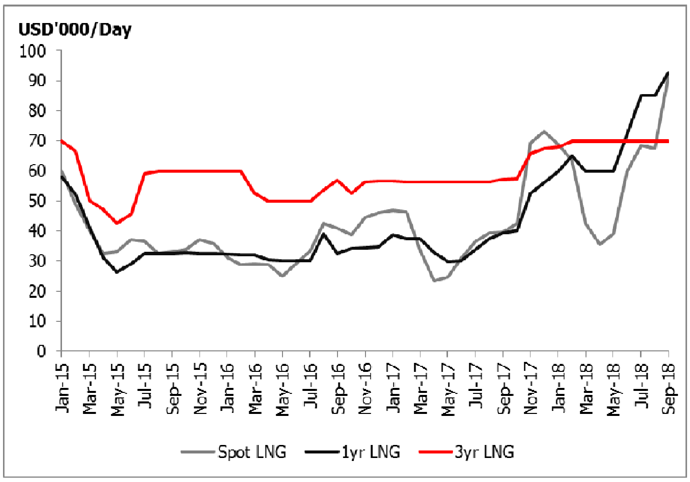
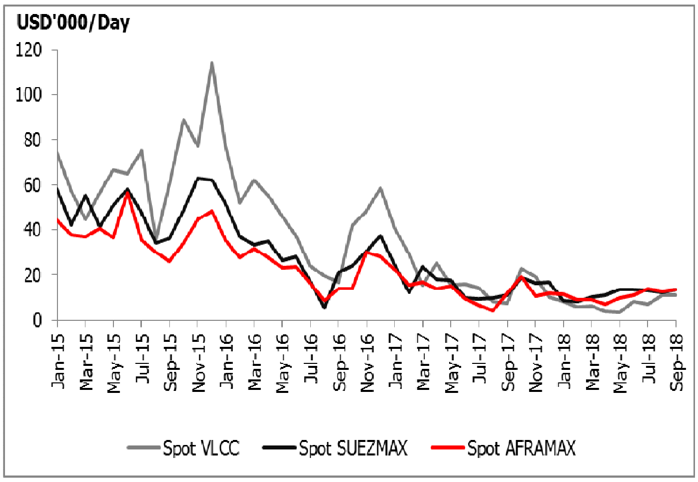


Figure 2: Spot Petroleum tanker rates (US$'000/day)



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	1,696.0	1,879.2
Pretax Profit (RM' m)	2,566.9	2,814.0	2,003.6	1,396.5	1,631.2
Net Profit (RM' m)	2,513.9	2,793.3	1,990.7	1,388.1	1,621.4
Normalised Profit (RM'm)	3,085.1	1,883.0	2,788.9	1,388.1	1,621.4
EPS (sen)	69.4	42.2	62.5	31.1	36.3
EPS growth (%)	75.4	-39.2	48.1	-30.3	16.8
PER (x)	9.5	15.6	10.6	21.2	18.2
Net Dividend (sen)	30.0	30.0	30.0	30.0	30.0
Net Dividend Yield (%)	4.5	4.5	4.5	4.5	4.5

Source: MIDFR, Company

DAILY PRICE CHART

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Source: Bloomberg

MISC BHD: 9MFY18 RESULTS SUMMARY

All in RM'm unless stated otherwise	Quarterly Results			Cumulative		Comments
FYE Dec	***3QFY18***	***%YoY***	***%QoQ***	***9MFY18***	***%YoY***	
Revenue	2,229.2	-3.7	4.1	6,391.8	-15.9	
COGS	(1,685.7)	8.0	3.8	(4,765.7)	-5.7	
Gross profit	543.5	-28.1	4.8	1,626.1	-36.2	
Other income	51.9	-49.8	1.4	168.9	-58.4	
SG&A	(240.9)	33.2	8.2	(710.1)	-19.2	
Operating profit	354.5	-47.7	2.2	1,084.9	-47.8	
Finance Cost	(109.9)	67.8	10.5	(285.1)	45.2	
Asso. & JV Contribution	39.8	-18.8	-43.1	122.4	-23.0	
Exceptional gain/(loss)	66.7	49.6	n.m.	66.6	-185.6	
Profit before tax	351.1	-50.3	10.2	988.8	-49.6	
Tax expense	(11.9)	-14.4	28.0	(31.4)	74.4	
PATAMI	341.0	-49.9	6.2	972.8	-49.1	
Normalised PATAMI	314.1	-61.8	-18.4	1,019.6	-52.9	Add back impairment loss on receivables

OPERATING SUMMARY (USD'm)

Segmental Revenue	***3QFY18***	***%YoY***	***%QoQ***	***9MFY18***	***%YoY***	***Comments***
LNG	147.6	-7.7	-2.2	447.4	-9.8	
Petroleum	257.0	6.6	0.6	761.1	-0.8	
Offshore	82.7	-12.3	13.0	231	-30.7	Absence of GKL adjudication
Heavy Engineering	71.4	41.1	21.2	176.1	8.1	
Total	558.7	2.3	3.8	1615.6	-8.2	
Segmental PBT	***3QFY18***	***%YoY***	***%QoQ***	***9MFY18***	***%YoY***	***Comments***
LNG	51.5	-41.2	-12.4	175.6	-37.1	Late surge in spot rates
Petroleum	(18.0)	3.7	-25.3	(60.5)	-287.8	
Offshore	49.3	-35.3	5.8	128.3	-33.7	Absence of GKL adjudication
Heavy Engineering	(5.5)	-252.8	-53.4	(23.9)	-582.9	Timing differences in profit recognition
Total	77.3	-48.0	11.2	219.5	-51.6	

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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.