

23 April 2018 | Corporate Update

MISC Berhad

Contract renewal risks linger

INVESTMENT HIGHLIGHTS

- Moderate fleet growth in LNG segment
- Scrapping activities to help petroleum segment
- Contract renewal risks linger in offshore division
- Heavy engineering outlook remains challenging
- Downgrade to **NEUTRAL** with reduced TP of **RM7.36**

Marginal net fleet growth. MISC received the delivery of Seri Camar in February 2018, the fourth of the five Seri C Class LNG vessels. This leaves one more vessel for delivery by 1HFY18 which will result in a net fleet growth of only one due to the disposal of Aman Bintulu in 1QFY17. The marginal growth in LNG fleet size may be dampened by the normalisation of Yemen LNG's deferred income for Seri Balhaf and Seri Balqis.

Sluggish LNG spot rates. We observe that on average, the LNG spot rates in 1Q18 declined by about -5.6% amidst the onset of warmer weather and oversupply of tonnage. This depressed spot rates trend is expected to persist due to the huge pile-up of new deliveries in 2018. Therefore, earnings of the LNG segment are expected to remain flat as we do not see much upside for earnings in the LNG segment.

Scrapping activities to help petroleum segment. Meanwhile, the petroleum segment is expected to stage a turnaround in 2HFY18 with sustainable oil demand from 2QCY18 as reported by the International Energy Agency, coupled with more scrapping activities and fewer newbuilds. Scrapping activities in petroleum shipping space is expected to increase amidst the current weak tanker market, strong prices for scrap steel and environmental regulations. As a result, petroleum tanker rates could be lifted by such environment. Moreover, higher term-to-spot ratio for its petroleum vessels acts as a sustainability factor for this segment.

Shift in management pattern for chemical fleets. Furthermore, four out of thirteen of its chemical tankers namely; (i) Bunga Lucerne; (ii) Bunga Lily; (iii) Bunga Lavender and; (iv) Bunga Lilac have been placed into a pool management system. The pool management systems works in a way whereby a pool manager acts on behalf of ships to obtain charterers. Moving forward, MISC Berhad may inject more chemical vessels into the tanker pool to leverage on scale and sustainability.

Downgrade to NEUTRAL

Previously BUY

Reduced Target Price (TP): RM7.36

(From: RM7.68)

RETURN STATS

Price (20 April 2018)	RM7.20
Target Price	RM7.36
Expected Share Price Return	+2.2%
Expected Dividend Yield	+4.2%
Expected Total Return	+6.4%

STOCK INFO

KLCI	1,887.75
Bursa / Bloomberg	3816 / MISC MK
Board / Sector	Main / Trading Services
Syariah Compliant	Yes
Issued shares (mil)	4,463.8
Market cap. (RM'm)	32,139.31
Price over NA	0.92
52-wk price Range	RM6.73 - RM7.90
Beta (against KLCI)	1.07
3-mth Avg Daily Vol	1.46m
3-mth Avg Daily Value	RM10.3m
Major Shareholders (%)	
Petronas	62.67
PNB	6.72
EPF	6.09

Renewal risk of FSO contracts. Under this segment, the FSO Benchamas 2 will commence operations from 2QFY18, marking the company's venture into Thailand's offshore oil and gas sector. Meanwhile, the FSO Puteri Dulang was awarded with a three year extension until 2021 and FPSO Cendor's change in contract period from 10 firm years with four one-year extensions option to 12 firm years with 2 one-year extension option effective from 1 January 2017. Notwithstanding this, other existing offshore contracts that are expiring in FY18 and FY19 such as FSO Angsi, FSO Orkid, FPSO Ruby 2 and FPSO Bunga Kertas are in the midst of renegotiations. Hence, this represents a contract renewal risk which may outweigh the impact from the new FSO and extension as overall earnings in the segment may decline amid the recognition of the finance lease.

Challenging outlook for heavy engineering. Outlook for the heavy engineering business appears challenging as orderbook replenishment remains challenging as new contract rollouts are limited. Overall segment contribution is less than 10% of total group profit.

Earnings impact. We are revising our earnings forecasts downwards for FY18 and FY19 by -10% and -6% respectively after taking into account: (i) the firmer Ringgit against the greenback compared to FY17; (ii) the normalisation of deferred income from Yemen LNG and; (iii) the impairment risk of receivables for Seri Balhaf and Seri Balqis.

Downgrade to NEUTRAL with reduced TP of RM7.36 per share (previously RM7.68 per share) pegged to 0.91x price-to-book value representing a discount of -0.75 standard deviation below its five-year average. Our neutral stance is predicated on: (i) sluggish LNG spot rates; (ii) contract renewal risk for its FSO projects and; (iii) low demolition in the LNG shipping space. These however, 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)

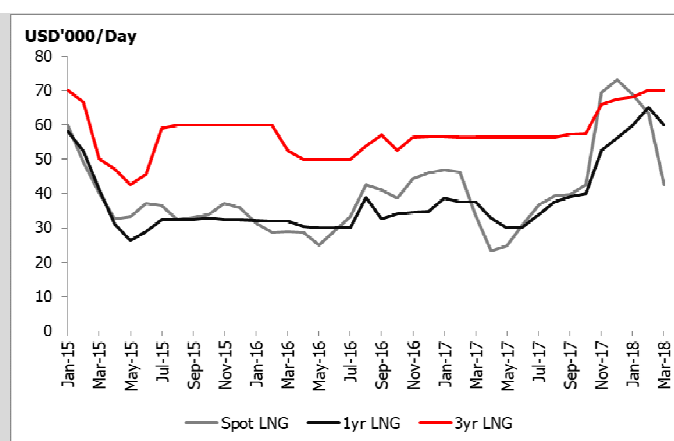
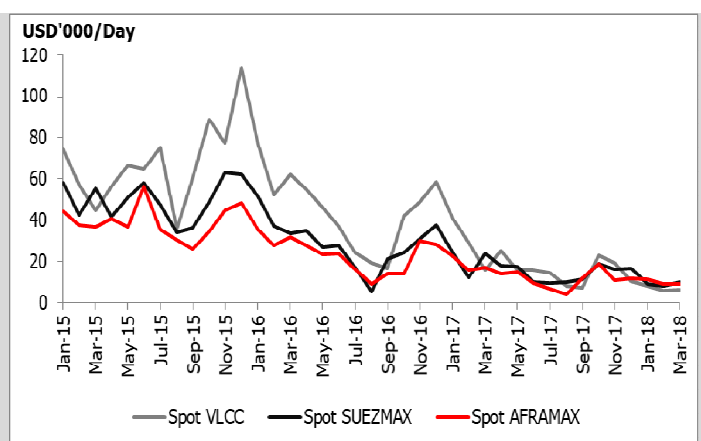


Figure 2: Spot Petroleum tanker rates (US\$'000/day)



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	10,072.5	10,246.1
EBIT (RM' m)	2,746.9	3,011.6	2,172.1	2,351.9	2,468.7
Pretax Profit (RM' m)	2,566.9	2,814.0	2,003.6	2,132.4	2,290.7
Net Profit (RM' m)	2,513.9	2,793.3	1,990.7	2,121.8	2,274.7
Normalised Profit (RM'm)	3,085.1	1,883.0	2,788.9	2,121.8	2,274.7
EPS (sen)	69.4	42.2	62.5	47.5	51.0
EPS growth (%)	75.4	-39.2	48.1	6.6	7.2
PER (x)	10.4	17.1	11.5	15.1	14.1
Net Dividend (sen)	30.0	30.0	30.0	30.0	30.0
Net Dividend Yield (%)	4.2	4.2	4.2	4.2	4.2

Source: MIDFR, Company

DAILY PRICE CHART



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Source: Bloomberg

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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 <i>rise</i> 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 <i>fall</i> 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.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.