# MISC Berhad

(3816 | MISC MK) Main | Transportation & Logistics

## *Maintain* Trading BUY

## *Revised* Target Price: RM8.41

**(Previously RM8.11)**

### Tanker rates boost normalized earnings

- **1QFY20 normalised earnings exceeded expectations**
- **Higher number of earnings days sustained LNG's profitability.**
- **Petroleum segment performed better supported by the surge in tanker spot rates**
- **Tanker spot rates remain strong in 2QFY20 due to demand for floating storage**
- **Earnings estimates revised upwards to reflect commendable tanker spot rates**
- **Maintain TRADING BUY with revised TP of RM8.41 per share**

**1QY20 normalised earnings exceeded estimates.** In 1QFY20, MISC Berhad (MISC) reported a loss-after-tax of –RM1.15b. After excluding exceptional items such as the provision for litigation claims for GKL, write-off of trade receivables and loss on re-measurement of finance lease receivables, MISC recorded normalised profit was RM765.9m (+59.7%yoy). This exceeded ours and consensus' estimates at 42.3% and 46.0% respectively. The positive variance came from the lower-than-expected finance costs which turned out >+20%yoy higher in addition to the strong tanker freight rates during the quarter under review.

**Higher number of earning days sustained LNG's profitability.** The revenue and normalised PBT of the LNG segment in 1QFY20 both increased by +8.9%yoy and +11.0%yoy respectively. The growth in revenue and PBT was mainly attributable to higher earning days following lower dry-docking activities in the current quarter. As a result, the impact of softening freight rates for LNG vessels towards the end of 1QFY20 were negated.

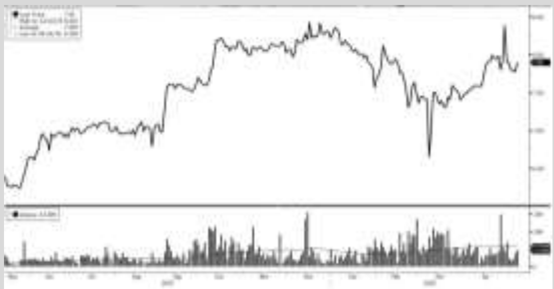
**Petroleum segment performs better in 1QFY20.** The petroleum shipping segment recorded a PBT which was almost +300%yoy higher in 1QFY20. The main driver for the segment's performance was the surge in tanker spot rates for all vessel types (VLCC, Suezmax, Aframax) amidst high tanker demand for floating storage. This was driven by the collapse in oil demand due to the Covid-19 pandemic which was later exacerbated by higher supply caused by the price war between Russia and Saudi Arabia.

**MISC's term to spot mix benefited well from tanker spot rate jump.** Tanker spot rates in 1QFY20 for Suezmaxes surged by more than +100%yoy while Aframaxes saw a +45.0%yoy jump. With MISC's Suezmax and Aframax fleet having a 65% and 34% exposure to the spot market respectively, these vessels were able to benefit from the surge in spot rates. Although 97% of the VLCC fleet is on term charter contracts, the time charter rates followed suit to rise but the rate of increase was not as high as spot rates.

**How has tanker rates fared so far in 2QFY20**? For the month of April 2020, we observed that tanker rates across the vessel classes (VLCC, Suezmax and Aframax) were higher than >+100%yoy. The month still saw oil traders scrambling to book storage options amidst the oil supply glut and the lack of onshore storage capacity. Spot tanker rates nevertheless experienced a slight retracement in May 2020 as the first impact of the production cuts agreed by OPEC+ started to be felt in the market.

| RETURN STATISTICS | |
|---|---|
| Price @ 8th May 2020 (RM) | 7.90 |
| Expected share price return (%) | +6.46 |
| Expected dividend yield (%) | +3.80 |
| **Expected total return (%)** | +10.26 |

**SHARE PRICE CHART**



| Share price performance (%) | Absolute | Relative |
|---|---|---|
| 1 month | 4.1 | 2.2 |
| 3 months | 6.2 | 11.3 |
| 12 months | 18.2 | 37.7 |

| KEY STATISTICS | |
|---|---|
| FBM KLCI | 1,382.31 |
| Syariah compliant | Yes |
| Issue shares (m) | 4463.75 |
| Estimated free float (%) | 22.54 |
| Market Capitalisation (RM'm) | 35,263.59 |
| 52-wk price range | RM6.35 - RM9.37 |
| Beta vs FBM KLCI (x) | 0.74 |
| Monthly velocity (%) | 0.09 |
| Monthly volatility (%) | 6.92 |
| 3-mth average daily volume (m) | 5.51 |
| 3-mth average daily value (RM'm) | 41.83 |
| Top Shareholders (%) | |
| Petroliam Nasional Bhd | 57.56 |
| Employees Provident Fund | 8.52 |
| PNB Associated Funds | 6.09 |

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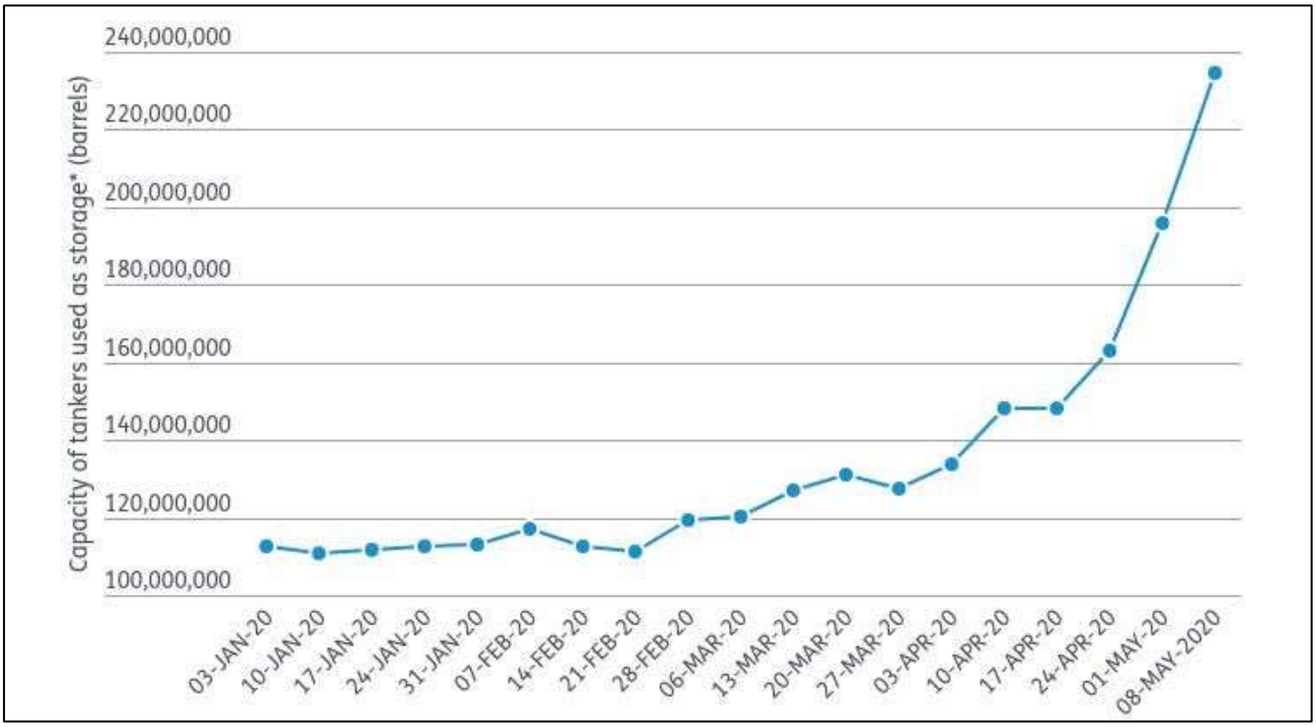
**Outlook for tanker rates in the medium term.** Overall, spot tanker rates are still expected to remain high in the near term. The reason being is that global stockpiles of petroleum products will grow by around 550 million barrels in 2QFY20 according to the International Energy Agency, prompting the need for storage facilities especially on sea. Moreover, market forecasts suggest that the world's conventional oil storage which can hold about 3.4 billion barrels will run out of storage space by end May 2020 and thereafter flow into floating storage in oil tankers.

**Figure 1: Tanker capacity used as floating storage**




*Source: Lloyd's List Intelligence*

**FPSO Mero 3 still being evaluated for offshore segment.** The offshore segment was badly hit by the provision for the litigation claims of GKL and the loss on re-measurement of finance lease receivables on 1QFY20. Excluding this one-off times, the PBT of the offshore segment was +50.8%yoy during the quarter under review which was partially supported by the gain from the extension of the joint venture in Vietnam. As major oil companies slash capital expenditure, MISC is carrying out evaluations together with Petrobras with regard to the FPSO Mero 3 Project.

**Heavy engineering segment remains in the black.** The heavy engineering segment reported its second quarterly net profit in 1QFY20, reversing the –RM29.4m loss after tax in the same period a year ago. The positive performance was mainly due to the higher recognition on the ongoing projects during the quarter notably from: (i) Bekok Oil project; (ii) Bergading CPP-MRU project and; (iii) the EPCIC Kasawari Gas Development project. As such, this partially offset the lower revenue from the conversion work during the quarter coupled with unabsorbed costs. MHB has received the greenlight to resume the operation of their yards from the Ministry of International Trade & Industry (MITI) on 16th of April 2020 but operations at the yards and docks are unlikely to resume as per pre-MCO due to social distancing currently being practiced. The impact from the almost four weeks of yard and dock closures could potentially lead to: (i) delayed completion of projects; (ii) deferment of revenue recognition and; (iii) deferment of vessels coming in for repairs and conversion works which we opine would adversely impact its earnings for 2QFY20.

**Earnings estimates.** As earnings exceeded our expectations, we are penciling in a more optimistic spot and time charter rate assumption for the petroleum segment. Therefore, our earnings estimates for FY20E/FY21F/FY22F have been adjusted by +21.0%/+32.1%/+21.6% respectively. Meanwhile, we note that our forecasts at this juncture have not incorporated the potential job wins related to FPSO segment by MISC pending announcements which will probably be announced in 2HFY20.

**Target price.** Post earnings revision and we are adjusting our target price to **RM8.41 per share** (previously RM8.11). Our TP is derived by pegging our FY21 book value per share to a 1.00x price-to-book value which is its five-year average.

**Maintain Trading BUY.** We remain encouraged by its long term prospect of MISC's exposure to the time charter contracts which will shield MISC from huge fluctuations seen in the spot market. Valuations are expected to be higher if the potential job wins for the offshore segment in FY20 worth around USD4.0b which includes FPSO Mero 3 and FPSO Limbayong. We also favour MISC for its attractive dividend yield of 3.8%. In terms of the provision for litigation claims for GKL made in 1QFY20, management guided that this is sufficient barring any unforeseen circumstances. Aside from that, MISC via GKL is advised that it has legal merits to challenge the award by the Arbitral Tribunal related to Sabah Petroleum dated 8 April 2020 and the company has done so with the outcome expected to be announced in the coming weeks.

Therefore, we are maintaining our **Trading BUY** call on MISC. Downside risks are: (i) further downward movement of tanker rates and; (ii) lack of demand for floating storage.

## INVESTMENT STATISTICS

| Financial year ending 31st December (in RM'm, unless otherwise stated) | 2018A | 2019A | 2020E | 2021F | 2022F |
|---|---|---|---|---|---|
| **Revenue** | **8,780.3** | **8,962.7** | **10,457.4** | **11,144.4** | **11,791.6** |
| EBIT | 1,333.5 | 1,929.2 | 2,432.0 | 2,728.0 | 3,034.7 |
| PBT | 1,344.1 | 1,512.3 | 2,305.0 | 2,678.0 | 2,814.7 |
| PATAMI | 1,311.5 | 1,426.3 | 2,189.8 | 2,544.1 | 2,674.0 |
| **Normalised PATAMI** | **1,495.6** | **1,673.7** | **2,189.8** | **2,544.1** | **2,674.0** |
| Normalised EPS (sen) | 33.5 | 37.5 | 49.1 | 57.0 | 59.9 |
| Normalised EPS Growth (%) | -46.4 | 11.9 | 30.8 | 16.2 | 5.1 |
| PER (x) | 23.6 | 21.1 | 16.1 | 13.9 | 13.2 |
| Dividend Per Share (sen) | 30.0 | 33.0* | 30.0 | 30.0 | 30.0 |
| Dividend Yield (%) | 3.8 | 4.2 | 3.8 | 3.8 | 3.8 |

*Source: Company, MIDFR*

**Inclusive of special dividend of RM0.03 per share declared*

## MISC: 1QFY20 RESULTS SUMMARY

| *All in RM'm unless stated otherwise* | Quarterly Results | | | | |
|---|---|---|---|---|---|
| **FYE Dec** | **1QFY20** | **4QFY19** | **1QFY19** | **%QoQ** | **%YoY** |
| **Revenue** | 2,513.8 | 2,375.5 | 2,277.7 | 5.8 | 10.4 |
| COGS | -1,505.7 | -1,607.5 | -1,517.8 | -6.3 | -0.8 |
| Gross profit | 1,008.1 | 768.0 | 759.9 | 31.3 | 32.7 |
| Other income | 135.2 | 80.9 | 87.2 | 67.1 | 55.0 |
| SG&A | -298.2 | -372.3 | -255.2 | -19.9 | 16.8 |
| **Operating profit** | 845.1 | 476.6 | 591.9 | 77.3 | 42.8 |
| Finance Cost | -95.8 | -118.4 | -134.2 | -19.1 | -28.6 |
| Assoc. & JV Contribution | 89.7 | 23.6 | 43.1 | >100 | >100 |
| Exceptional gain/(loss) | -1,984.4 | -118.1 | 41.2 | >100 | <-100 |
| Profit before tax | -1,145.4 | 263.7 | 542.0 | <-100 | <-100 |
| Taxation | -5.6 | -16.3 | -26.0 | -65.6 | -78.5 |
| PATAMI | -1,156.8 | 249.9 | 510.5 | <-100 | <-100 |
| **Normalized PATAMI** | 765.9 | 409.2 | 479.7 | 87.2 | 59.7 |
| **Operating Summary (USD'm)** | | | | | |
| **Segmental Revenue** | **1QFY20** | **4QFY19** | **1QFY19** | **%QoQ** | **%YoY** |
| LNG | 166.4 | 155.6 | 152.8 | 6.9 | 8.9 |
| Petroleum | 293.7 | 278.2 | 286.9 | 5.6 | 2.4 |
| Offshore | 56.9 | 71.4 | 66.0 | -20.3 | -13.8 |
| Heavy Engineering | 82.8 | 66.2 | 49.6 | 25.1 | 66.9 |
| Total | 599.8 | 571.4 | 555.3 | 5.0 | 8.0 |
| **Segmental PBT** | **1QFY20** | **4QFY19** | **1QFY19** | **%QoQ** | **%YoY** |
| LNG | 77.5 | 52.5 | 79.9 | 47.6 | -3.0 |
| Petroleum | 71.0 | 16.1 | 18.0 | 341.0 | 294.4 |
| Offshore | (425.2) | 7.3 | 32.7 | <-100 | <-100 |
| Heavy Engineering | 1.4 | 0.8 | (7.2) | 75.0 | <-100 |
| Total | (275.3) | 76.7 | 123.4 | <-100 | <-100 |

*Source: Company, MIDFR*

# DISCLOSURES AND DISCLAIMER



| 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. |
| **NEGATIVE** | The sector is expected to underperform the overall market over the next 12 months. |