MISC Berhad

(3816 | MISC MK) Main | Transportation & Logistics

Maintain NEUTRAL

***Revised* Target Price: RM8.11**
(Previously RM8.35)

Covid-19 outbreak may exert pressure on tanker market

- **FY19 results were higher but missed expectations**
- **Higher number of operating vessels sustained LNG's profitability.**
- **Petroleum segment returns to the black in FY19 due to surge in freight rates in 4QFY19**
- **Offshore contract extensions cushion impact of provision for demobilization cost of FSO Angsi**
- **Heavy engineering stuck in losses albeit at a lower level**
- **Earnings estimates revised downwards**
- **Maintain NEUTRAL with revised TP of RM8.11 per share**

FY19 was higher but missed estimates. In 4QFY19, normalised earnings MISC Berhad (MISC) came in at RM409.2m (-16.9%yoy). Notwithstanding this, MISC's cumulative FY19 normalised earnings amounted to RM1.67b (+11.9%yoy) which was below our expectations at 92.0% but broadly met consensus' estimates at 94.5%. The negative variance came from the higher-than-expected finance costs which turned out >+20%yoy higher, partially outweighing the gains from the stronger freight rates for petroleum and LNG shipping.

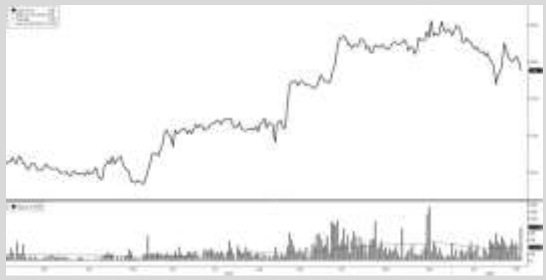
Higher number of operating vessels sustained LNG's profitability. The revenue and PBT of the LNG segment in FY19 both increased by +7.2%yoy and +23.3%yoy respectively. The growth in revenue and PBT was mainly attributable to the higher number of operating vessels following: (i) the acquisition and leaseback of LNG Lerici and LNG Portovenere on time charter contracts in December 2018 and January 2019 respectively; and (ii) additional charter rates for Floating Storage Units as a result of retrofitting works done. Overall, this helped to overcome the impact of lower charter rates especially in 4QFY19 which was lower by more than -30%yoy.

Petroleum segment performs better in FY19. The petroleum shipping segment returned to profit for FY19 after two consecutive years of losses. The main driver for the segment's performance was the surge in tanker spot rates for all vessel types (VLCC, Suezmax, Aframax) in 4QFY19 to a level not reached since 2016. The time charter rates followed suit but the rate of increase was not as high as spot rates which jumped by more than three times. Overall, this mainly benefited Suezmax and Aframax vessels which has a 26.0% and 56% exposure to the spot market while all MISC's VLCCs were on time charter contracts. The 4QFY19 spike in tanker rates was underpinned by geopolitical events (attacks on Saudi facilities, U.S sanctions on COSCO vessels) and regulatory factors (IMO 2020 implementation).

How has tanker rates fared so far? So far in 1QFY20, Average spot tanker rates have shown a steep decline of more than 20% since the start of FY20 due to subdued winter season which coincided with the Covid-19 outbreak. We gathered from the management that the exposure of MISC's petroleum vessels to China is minimal. Nevertheless, if the Covid-10 outbreak extends beyond March 2020, there could be a spillover effect from China's slowing demand to the global oil market. As such, tanker spot and time charter rates will face further downward pressure in addition to the seasonal lull in 1HFY20.

RETURN STATISTICS	
Price @ 18th Feb 2020 (RM)	7.88
Expected share price return (%)	+2.92
Expected dividend yield (%)	+3.80
Expected total return (%)	**+6.72**

SHARE PRICE CHART



Share price performance (%)	Absolute	Relative
1 month	-3.9	-0.2
3 months	-5.6	-0.3
12 months	14.2	25.8

KEY STATISTICS	
FBM KLCI	1,537.08
Syariah compliant	Yes
Issue shares (m)	4463.75
Estimated free float (%)	19.00
Market Capitalisation (RM'm)	35,174.32
52-wk price range	RM6.38 - RM9.41
Beta vs FBM KLCI (x)	0.95
Monthly velocity (%)	19.60
Monthly volatility (%)	6.92
3-mth average daily volume (m)	3.69
3-mth average daily value (RM'm)	30.53
Top Shareholders (%)	
Petroliam Nasional Bhd	57.56
PNB Associated Funds	9.01
Employees Provident Fund Board	7.37

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Offshore contract extensions cushioned impact of provision for demobilisation cost. Revenue and PBT of the offshore segment in of the offshore segment in FY19 was lower by -11.5%yoy and -41.4%yoy respectively due to the recognition of the demobilisation cost for FSO Angsi during the year which amounted to roughly RM60m. All in, the charter commencement of the FSO Mekar Bergading in August 2018 and the contract extension for FPSO Ruby 2 and FPSO Bunga Kertas to early FY20 cushioned the segment's losses.

Losses narrowed down for heavy engineering segment. Losses-before-tax for the heavy engineering segment narrowed by –68.4%yoy in FY19. This corresponds to the higher revenue incurred from: (i) dry docking services on LNG carriers during the period; (ii) higher progress of ongoing projects; and (iii) lower unabsorbed overheads. There are several projects that are expected to be completed from 2QFY20 onwards which we opine will assist to cushion earnings whilst waiting for more significant revenue recognition to come from Bokor and Kasawari projects. Furthermore, with the expected completion of Dry Dock 3 (DD3) in 3QFY20, we anticipate more marine repair works and conversions to take place as DD3 will be able to relieve the bottleneck currently experienced by Dry Dock 1 (DD1). Additionally, this would also allow the heavy engineering segment to take in more LNG carriers

Earnings estimates. Due to the waning oil demand from China which may subsequently spread to the overall market if the Covid-19 outbreak is not contained before 1QFY20 ends, we are penciling in a more conservative spot and time charter rate assumption for the petroleum segment. As such our earnings estimates for FY20E and FY21F have been lowered by -2.9% and -1.8% respectively. We have also introduced our FY22F estimates in this report. 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 are expected in 1HFY20.

Target price. Post earnings revision and rolling forward our valuation base year to FY21, we are adjusting our target price to **RM8.11** per share (previously RM8.35). Our TP is derived by pegging our FY21 book value per share to a 1.00x price-to-book value (previously 1.05x), which is its five-year average, reflecting our conservativeness broad market uncertainty from the Covid-19 outbreak.

Maintain NEUTRAL. MISC's LNG segment is expected to remain resilient due to the small exposure to the LNG spot market while any force majeure declaration by Chinese firms will still require LNG vessel charterers to honour the contract with MISC being the vessel owner. As for the petroleum segment, the coronavirus outbreak and its drag on global oil demand is pressuring the group to slash output even further. OPEC+ has yet to agree to any further cuts, mainly due to Russia's resistance. But the group may ultimately need to go beyond announced restrictions of more than 500,000 barrels a day as the virus slowly erodes demand for crude. Moreover, the U.S. Energy Information Administration cut its global oil demand growth forecast for this year by 310,000 barrels per day while the OPEC slashed its oil demand growth for 1QCY20 by 440,000 barrels per day. Therefore, freight rates for petroleum tankers will likely face downward pressure. As for heavy engineering, we opine that the segment becomes profitable due to: (i) better revenue recognition from projects expected to be completed from 2QFY20 onwards; (ii) higher revenue recognition from its Bokor CPP project and; (iii) more dry docking and fabrication activities once its Dry Dock 3 comes onboard in 3QFY20. However, heavy engineering's impact to MISC's bottom line will still be below 5.0%. With much of the positive factors being moderated by potential headwinds from the Covid-19 outbreak, we are maintaining our **NEUTRAL** stance on MISC. The catalysts for MISC are: (i) sooner-than-expected containment of the coronavirus and (ii) the potential job wins for the offshore segment in FY20 worth around USD4b which includes FPSO Mero 3 and FPSO Limbayong.

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**	**10,057.4**	**10,494.4**	**11,091.6**
EBIT	1,333.5	1,929.2	2,032.0	2,078.0	2,334.7
PBT	1,344.1	1,512.3	1,905.0	2,028.0	2,274.7
PATAMI	1,311.5	1,426.3	1,809.8	1,926.6	2,161.0
Normalised PATAMI	**1,495.6**	**1,673.7**	**1,809.8**	**1,926.6**	**2,161.0**
Normalised EPS (sen)	33.5	37.5	40.5	43.2	48.4
Normalised EPS Growth (%)	-46.4	11.9	8.1	6.5	12.2
PER (x)	23.5	21.0	19.4	18.3	16.3
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: 4QFY19 RESULTS SUMMARY

Financial year ending 31st December (in RM'm, unless otherwise stated)	Quarterly			Cumulative		
	4Q19	YoY (%)	QoQ (%)	12M19	12M18	YoY (%)
Revenue	2,375.5	-0.5	10.6	8,962.7	8,780.3	2.1
COGS	-1,607.5	-4.4	1.8	-6,215.6	-6,447.5	-3.6
Gross profit	768.0	8.7	35.0	2,747.1	2,332.8	17.8
Other income	80.9	-12.5	29.6	288.0	261.4	10.2
SG&A	-372.3	-10.9	46.1	-1,105.9	-1,127.9	-2.0
Operating profit	476.6	25.0	26.6	1,929.2	1,466.3	31.6
Finance Cost	-118.4	8.1	2.0	-484.3	-394.6	22.7
Asso. & JV Contribution	23.6	-85.3	-71.4	250.6	283.3	-11.5
Exceptional gain/(loss)	-118.1	52.4	>100	-183.2	-10.9	>100
Profit before tax	263.7	-25.8	-8.3	1,512.3	1,344.1	12.5
Tax expense	-16.3	-42.6	-1.8	-76.1	-59.8	27.3
PATAMI	0.0	-26.2	-6.1	1,426.3	1,311.5	8.8
Core PATAMI	249.9	-16.9	25.9	1,673.7	1,495.6	11.9

OPERATING SUMMARY (USD'm)

Segmental Revenue	4Q19	YoY (%)	QoQ (%)	12M19	12M18	YoY (%)
LNG	155.6	16.0	-0.4	623.3	581.5	7.2
Petroleum	278.2	-9.6	18.3	1039.2	1069.0	-2.8
Offshore	71.4	9.2	14.2	262.3	296.4	-11.5
Heavy Engineering	66.2	1.2	8.3	243.8	241.5	1.0
Total	571.4	-0.2	11.0	2168.6	2188.4	-0.9
Segmental PBT	**4Q19**	**YoY (%)**	**QoQ (%)**	**12M19**	**12M18**	**YoY (%)**
LNG	52.5	82.3	-8.7	252.1	204.4	23.3
Petroleum	16.1	>100	<-100	12.4	-59.6	<-100
Offshore	7.3	-87.6	-78.8	109.8	187.3	-41.4
Heavy Engineering	0.8	<-100	<-100	-9.5	-30.1	-68.4
Total	76.7	-7.0	8.9	364.8	302.0	20.8

Source: Company, MIDFR

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