KDN: PP 10744/04/2010

midf RESEARCH

Equity Beat

01 March 2010

1HFY10 Results Review

Sime Darby Berhad

More skeleton in the Energy & Utilities' closet?

Maintain **NEUTRAL**

Revised **Target Price (TP): RM8.70 (from RM8.30)**

- **Sime Darby registered a net earnings of RM1,112.8m in 1HFY10, which is equivalent to 48%, 39% and 45% of ours, consensus and Sime Darby's full-year estimates respectively.**
- **Industrial division showed lower operating profit and Energy & Utilities bled red ink. However, the improved results from Plantation, Property, Motor, Healthcare and Other divisions partly mitigated the decline in 1HFY10 net earnings.**
- **The historical mean PER of Sime Darby is 17x, with a lower and an upper band of 10x and 24x respective. In view of the hitherto accommodative liquidity situation, we expect the PER rating of a key index stock such as Sime Darby to hover within the premium half of its PER band. At 66-percentile point, we arrived at a value of RM8.70 on FY11 earnings. We thereby maintain our NEUTRAL recommendation on the stock with a revised target price of RM8.70.**

STOCK INFO

Price (25 Feb 10)	RM8.45	KLCI	1,270.78
Issued shares (mil)	6,009.5	Bursa / Bloomberg	4197/SIME MK
Par Value (RM)	0.50	Board / Sector	Main/ Trading
Market cap. (RM'm)	50,780.0	Syariah Compliant	Yes
Price over NTA	2.39		
52-wk price Range	RM5.30–RM9.24	Major Shareholders	
Beta (against KLCI)	1.14	Sekim Amanah Saham Bumiputra	36.31%
3-mth Avg Daily Vol	5.63m	PNB	15.52%
3-mth Avg Daily Value	RM47.6m	EPF	14.12%

Sime Darby's net earnings of RM1,112.8 million in 1HFY10 was a decrease of 2.9% when compared to RM1,145.5 million in last year's corresponding period. The decrease was due mainly to the lower contribution from Industrial and Energy & Utilities divisions, and higher tax charges.

Plantation division downstream profit and increased sales volume helped see profit higher. The Plantation division revenue declined 10.0% to RM5,457.5 million in 1HFY10 from RM6,065.0 million in the same period last year. Its operating profit however improved to RM1,269.7 million in 1HFY10, an increase of 13.9% as compared to RM1,114.5 registered in the same period last year. The better profit performance was achieved on the back of a 7% increase in FFB output, a 16% increase in the sales volume of CPO and profit from the downstream operations. The increase in sales volume of CPO mitigated the effects of lower average CPO selling price of RM2,222/mt as compared to RM2,304/mt for the previous year. The bigger output and sales volume were partly contributed by the maturing age profile of oil palm trees and the operational improvements of its Indonesian estates. Indonesian yields rose to 10.5 MT/ha from 8.3 MT/ha while oil extraction rates increased to 23.1% in 1HFY10 from 22.4% over the same period last year.

Recovery in the market and gain on disposal boosted profit for Property division. The gradual economic upturn

FYE 30 Jun	FY08	FY09	FY10E	FY11F
Revenue (RM'm)	34,044.7	31,013.9	32,036.2	33,914.2
EBIT (RM'm)	5,213.8	3,165.5	3,523.9	4,069.4
Pretax Profit (RM'm)	5,206.4	3,071.6	3,473.6	4,034.0
Net Profit (RM'm)	3,512.1	2,280.1	2,327.3	2,702.8
EPS (sen)	59.6	37.9	38.7	45.0
EPS (%)	35.0%	-36.4%	2.1%	16.1%
PER (x)	14.2	22.3	21.8	18.8
N Div (sen)	34.5	19.0	23.0	27.0
N Div (%)	4.1%	2.2%	2.7%	3.2%

Source: Company, Forecasts by MIDFR

has helped in the recovery of property market hence the strong performance of the Property division. It reported revenue of RM676.3 million for 1HFY10, a 19.4% increase from the corresponding period last year. Operating profit (which includes a RM37.5 million gain from the disposal of a subsidiary company) increased by 31.7% to RM179.0 million from the same period last year, partly contributed by the better performance from the Bukit Jelutong and Nilai Impian townships.

Lower profit figure for Industrial division due to depressed the operating margins. Revenue from the Industrial division inched up by 0.6% in 1HFY10 to RM4,087.2 million from RM4,061.4 million a year earlier. On the other hand, operating profit declined by 15.1% to RM377.0 million from RM443.8 million in the same period last year. The lower profit figure was due to the depressed operating margins in Australia and Singapore attributable to slower off-take for new equipment and power systems. The deferments in capital expenditure by customers in light of depressed economic conditions last year also contributed to lower sales in Australia and Singapore. However, China operations registered some improvement due to higher equipment sales for infrastructure projects.

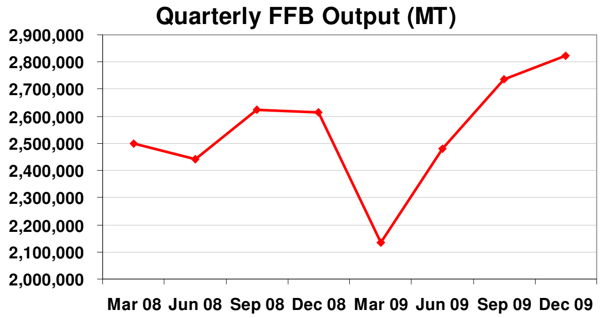
Economic recovery and gain on disposal helped Motor's top and bottom lines. The Motors division performed strongly with a 36.8% increase in revenue to RM4,694.5 million from RM3,432.2 million in the same period last year. Operating profit (which includes a gain of RM27.7 million from the disposal of a property) increased almost in tandem by 31.5% to RM147.9 million from RM112.5 million in the prior year. Better top and bottom line numbers were partly due to the improved results from operations in Singapore, New Zealand and Thailand, in line with the rebound in global economic conditions.

Cost escalation on engineering projects dragged the Energy & Utilities division into the red. The Energy & Utilities division recorded 34.7% lower revenue to RM996.7 million from RM1,526.8 million in 1HFY09. The division recorded an operating loss of RM109.6 million (1HFY09: +RM56.3 million) attributable to cost escalation on fabrication and engineering projects as a result of higher off-shore costs, and lower revenue in the oil & gas sector. Its Oil & Gas and Engineering business unit showed a 44% decline in revenue as compared to the same period last year. The unit is also faced with issues relating to operational efficiency and project management. Nevertheless, a new management team has been installed to tackle these problems.

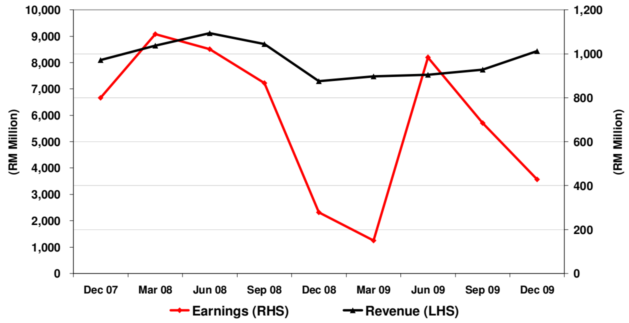
Healthcare & Other are doing fine. Healthcare & Others recorded a 233.0% increase in 1HFY10 operating profit to RM30.3 million (1HFY09: RM9.1 million) due to the better overall performance from insurance, bedding and healthcare sectors, together with the gain on disposal of an associate amounting to RM3.8 million. Corporate expenses was lower due mainly to the inclusion of FX gains totaling RM14.9 million in 1HFY10 as compared to a loss of RM99.7 million in the corresponding period last year.

Outlook. The economic recovery has provided the momentum for the property, motors and healthcare businesses which have shown improved performance in 1HFY10. The market condition for the industrial business however was depressed but is improving. The prospects for the mainstay plantation business is positive as the outlook relating to CPO prices remain favorable but the sequential FFB output in 2HFY10 is expected to be lower due to seasonal factor. The Energy & Utilities division meanwhile suffered from losses in the oil and gas sector arising from cost escalations estimated at more than RM100 million. The losses are believed to be from the RM1 billion Qatar Petroleum contract which was awarded in 2006 and completed last year. However, that may not be the end of the suffering. The other contract is the Maersk Oil Qatar contract (awarded in 2007 and completed in 2009) worth more than RM2 billion, which has been speculated to have incurred cost escalations of as high as RM800 million. Variation orders (VOs) are said to have been put in and negotiations are ongoing, however Sime Darby has not officially disclosed the amounts of the cost escalations. To err on the side of caution, we are of the opinion that Sime Darby's earnings performance for FY10 may fall short of its own internal target. In 1HFY10, Sime Darby had achieved a net profit of RM1,112.8 million which is approximately 45% of its full-year target.

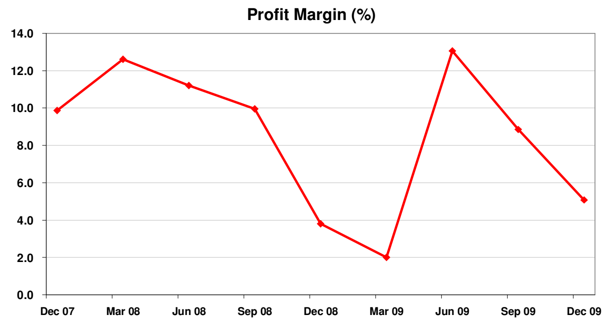
We maintain our NEUTRAL recommendation with a revised target price of RM8.70. The historical mean PER of Sime Darby is 17x, with a lower and an upper band of around 10x and 24x respectively (see PER chart below). Applying that empirical measures on FY11 earnings, we arrived at lower, mean and upper band prices of RM4.50, RM7.65 and RM10.80 respectively. In view of the hitherto accommodative liquidity situation, we expect the PER rating of a key index stock such as Sime Darby to hover within the premium half of its PER band. At 66-percentile point, we arrived at a value of RM8.70. We thereby maintain our **NEUTRAL** recommendation on the stock with a revised target price of RM8.70.



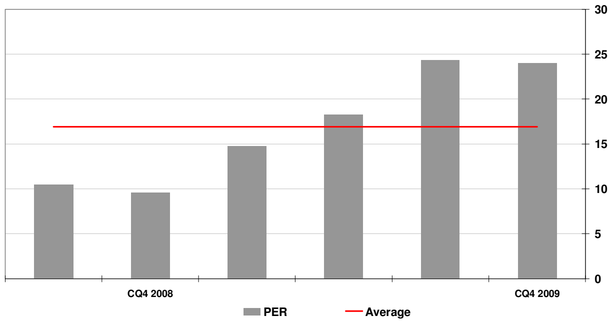
FFB output risen 7.9%yoy in 2QFY10. But expect FFB output to show sequential drop in the next two quarters due to the cyclical downturn in crop yields.



Earnings worsened QoQ mainly due to the loss incurred by its Oil & Gas unit and lower contribution from the Industrial division.



Profit margin retreated to single-digit for the past two quarters.



Historical mean PER of 17x.

Sime Darby: 1HFY10 RESULTS SUMMARY

	Quarterly Results			Cumulative		Comments
FYE June (RM m)	**2Q10**	***%YoY***	***%QoQ***	**1H10**	***%YoY***	
Revenue	8,432.7	*15.5%*	*9.0%*	16,169.1	*1.0%*	Rise in revenues of Property and Motors mitigated decline in Plantation and Energy & Utilities
Operating profit	831.9	*110.8%*	*-16.2%*	1,824.7	*11.5%*	
Interest income	27.2	*-41.5%*	*27.7%*	48.5	*-51.1%*	
Interest expense	-77.9	*20.2%*	*36.9%*	-134.8	*5.5%*	
Pre-tax profit	783.2	*98.0%*	*-20.3%*	1,765.4	*7.1%*	Better profit from all divisions save Industrial and Energy & Utilities divisions
Tax	-318.4	*191.3%*	*21.8%*	-579.8	*20.1%*	High tax charges
Net Profit	428.2	*53.8%*	*-37.5%*	1,112.8	*-2.9%*	
EPS (sen)	7.1	*54.0%*	*-37.4%*	18.5	*-2.8%*	
		+/- ppts	***+/- ppts***		***+/- ppts***	
Op margin (%)	9.9%	*4.5*	*-3.0*	11.3%	*1.1*	
Tax rate (%)	40.7%	*13.0*	*14.0*	32.8%	*3.6*	
Segmental						
Revenue:						
Plantation	2,737.2	*-54.9%*	*0.6%*	5,457.5	*-10.0%*	Lower CPO selling prices
Property	405.5	*-28.4%*	*49.7%*	676.3	*19.4%*	Recovery in property market
Industrial	2,086.1	*-48.6%*	*4.2%*	4,087.2	*0.6%*	Rising sales in China offset lower demand from Singapore and Australia
Motors	2,527.4	*-26.4%*	*16.6%*	4,694.5	*36.8%*	Better sales in Singapore, New Zealand and Thailand
Energy and Utilities	542.1	*-64.5%*	*19.2%*	996.7	*-34.7%*	Lower revenue in oil & gas sector
General trading, services and other	134.4	*-61.9%*	*9.7%*	256.9	*-27.2%*	
Operating Profit:						
Plantation	636.1	*-42.9%*	*0.4%*	1,269.7	*13.9%*	Improvement in output and yields of Indonesian estates
Property	120.0	*-11.7%*	*103.4%*	179.0	*31.7%*	Recovery in market and gain on disposal
Industrial	188.8	*-57.5%*	*0.3%*	377.0	*-15.1%*	Depressed margins in Singapore and Australia
Motors	84.1	*-25.2%*	*31.8%*	147.9	*31.5%*	Better sales in Singapore, New Zealand and Thailand
Energy and Utilities	-175.8	*-412.3%*	*-365.6%*	-109.6	*-294.7%*	Cost escalation on fabrication and engineering projects
General trading, services and other	13.5	*48.4%*	*-19.6%*	30.3	*233.0%*	
Operating Margin:		***+/- ppts***	***+/- ppts***		***+/- ppts***	
Plantation	23.2%	*4.9*	*-0.1*	23.3%	*4.9*	
Property	29.6%	*5.6*	*7.8*	26.5%	*2.5*	
Industrial	9.1%	*-1.9*	*-0.4*	9.2%	*-1.7*	
Motors	3.3%	*0.0*	*0.4*	3.2%	*-0.1*	
Energy and Utilities	-32.4%	*-36.1*	*-47.0*	-11.0%	*-14.7*	

General trading, services and other	10.0%	*7.5*	*-3.7*	11.8%	*9.2*	
Plantation Stats:						
CPO Sime (RM/MT)	2,199	*32.7%*	*-2.0%*	2,222	*-3.6%*	Lower CPO selling price
CPO Market (RM/MT)	2,318	*44.5%*	*3.4%*	2,281	*4.2%*	
FFB production ('000 MT)	2,822.2	*7.9%*	*3.1%*	5,560.2	*6.1%*	Partly due to improvements in Indonesian operations

Source: Company, MIDFR

DAILY PRICE CHART

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <15% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >15% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
OVERWEIGHT	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.
UNDERWEIGHT	The sector is expected to underperform the overall market over the next 12 months.