27 May 2019 | 1QFY19 Results Review

MISC Berhad

Maintain NEUTRAL

Geopolitics to weigh on petroleum tanker segment

***Revised* Target Price (TP): RM6.81**
(from RM6.93)

INVESTMENT HIGHLIGHTS

- **1QFY19 normalised earnings broadly within expectations**
- **Addition of LNG Lerici and LNG Portovenere of vessels propelled the LNG segment**
- **Better freight rates retained the profitability of the petroleum segment**
- **Geopolitics and possible extension of output cuts to put pressure petroleum segment**
- **Earnings forecast unchanged**
- **Maintain NEUTRAL with a revised TP of RM6.81 per share due to rollover of valuation**

1QFY19 results broadly within expectations. MISC Berhad (MISC) reported a normalised PATAMI of RM479.6m (+47.9%yoy) in 1QFY19 which was broadly within ours and consensus' expectations, accounting for 28.0% and 29.0% of fuel year forecasts, respectively. The higher than +50%yoy jump in finance costs due to the MFRS 16 adoption and cash drawdown for new vessels was offset by better revenue from its energy shipping business (i.e., LNG and petroleum shipping).

Addition of vessels propels LNG segment. The revenue and PBT of the LNG segment in 1QFY19 both increased by +2.6%yoy and +22.4%yoy respectively. The growth in revenue and PBT was mainly attributable to the higher number of operating vessels following the acquisition and leaseback of LNG Lerici and LNG Portovenere on time charter contracts in December 2018 and January 2019 respectively.

Better freight rates retains petroleum segment in the black. Despite the seasonal softness after the winter season, the petroleum segment registered a profit before tax for the second consecutive quarter in 1QFY19 due to higher freight rates compared to 1QFY18. The strength in freight rates was mainly underpinned by slow fleet growth for the quarter under review amidst accelerated scrapping activity last year.

FSO Mekar Bergading cushioned impact from absence of construction revenue. Revenue of the offshore segment was -12.1%yoy lower in 1QFY19 due to the absence of the construction revenue from FSO Benchamas 2. Nevertheless, the charter commencement of the FSO Mekar Bergading in August 2018 and the contract extension for FPSO Ruby 2 marginally increased the segment's PBT by +0.9%yoy.

Heavy engineering segment stuck in losses. The heavy engineering segment posted its fifth consecutive quarter of losses in 1QFY19. Weakness in the quarter-under-review mainly came from higher unabsorbed overheads due to: (i) lower dry docking activities under its marine segments and (ii) expected contract awards which have yet to materialise for the heavy engineering business.

RETURN STATS	
Price (24 May 2019)	RM6.52
Target Price	RM6.81
Expected Share Price Return	+4.4%
Expected Dividend Yield	+4.6%
Expected Total Return	**+9.0%**

STOCK INFO	
KLCI	1,598.32
Bursa / Bloomberg	3816 / MISC MK
Board / Sector	Main / Transportation & Logistics
Syariah Compliant	Yes
Issued shares (mil)	4,463.8
Market cap. (RM'm)	29,103.62
Price over NA	0.84
52-wk price Range	RM5.03 - RM7.22
Beta (against KLCI)	0.92
3-mth Avg Daily Vol	1.11m
3-mth Avg Daily Value	RM7.55m
Major Shareholders (%)	
Petronas	62.67
PNB Associated Funds	9.01
EPF	6.54

Preparation for IMO 2020 ruling. Effective from 1 January 2020, the IMO 2020 regulations will cap the sulphur content of shipping fuel at 0.5%, potentially leading to higher fuel costs in general. Shown below are MISC's plans for its various fleet categories in relation to the upcoming IMO 2020 ruling:

- **LNG:** For MISC's LNG vessels, majority of the vessels are time chartered out with bunker costs being borne by the charterer. Hence, there are no plans to install scrubbers for its LNG fleet.
- **VLCC:** Meanwhile, MISC has guided that six out of its 12 Very Large Crude Carriers (VLCC) will be retrofitted with scrubbers before 2020 upon the request by the charterers. We expect higher freight rates from the retrofitted vessels due to the advantage of using cheaper fuel borne by the charterer. Although the payback periods for scrubbers are short, the economic viability of scrubbers may diminish in the long term due to a risk from a narrowing price spread between low sulphur and high sulphur fuel. In addition, countries such as Singapore and China have banned vessels operating open-loop scrubbers with other nations expected to follow suit amidst the European Union's draft submission to the IMO for harmonized wastewater discharge rules.
- **Aframax and Suezmax:** With little details revealed for plans for its Aframax and Suezmax fleet, we believe that the installation of scrubbers will be lower for both fleet categories to adhere to its overarching strategy of adopting IMO 2020 compliant fuel. This is made possible by its two newbuild LNG dual fuel tanker, Eagle Brasilia and Eagle Bintulu after receiving it in 1QFY19. The risk would prevail for the fleets without scrubbers that are on spot charter arrangements whereby MISC will bear the higher fuel cost and try to pass it on to customers. This could be done via higher spot rates, depending on the prevailing supply and demand dynamics of the petroleum tanker market.

Earnings impact. We are making no changes to our earnings estimates as normalised earnings were broadly within expectations.

Target price. While no adjustments are made to our earnings forecast, we have revised out **target price** to **RM6.81 per share** (from RM6.93 per share previously) as we roll forward our valuation base period to FY20. Our TP is derived by pegging our FY20 book value per share to a 0.85x price-to-book value (from 0.87x), as we increase the discount to -0.75 (from -0.5) standard deviation below its five-year average. Our premise for the higher discount is due to the impending risks from the IMO2020 regulation and the geopolitical situation which especially may affect the petroleum segment.

Maintain NEUTRAL. Growth in FY19 will come from new liquefaction projects and China's reduced reliance on coal which we believe will propel LNG growth. Any downturn in LNG will be mitigated by its major existing portfolio of long term contracts. The offshore segment too will be buoyed by the full year contribution of its two new assets; FSO Mekar Bergading and FSO Benchamas 2. Meanwhile, the impact on freight rates coming from reduced active petroleum fleet due to the downtime for scrubber retrofits leading up to the IMO 2020 implementation will be outweighed by scrapping activities. Moreover, the scrapping activities have yet to match the order book for deliveries that we expect to be sizeable up to end 2019 before tapering in 2020. Pressure on the recovery in tanker shipping demand will also be increased due to sanctions on Venezuela and Iran, combined with potential output cut extension beyond June by the OPEC. As for heavy engineering, even if the segment becomes profitable due to marine repair activities amidst impending compliance of the IMO 2020 sulphur cap, contribution to MISC's bottom line will still be below 5.0%. With the positive factors being moderated by potential headwinds, we are maintaining our **NEUTRAL** stance on MISC Berhad.

Figure 1: LNG tanker rates (US$'000/day)

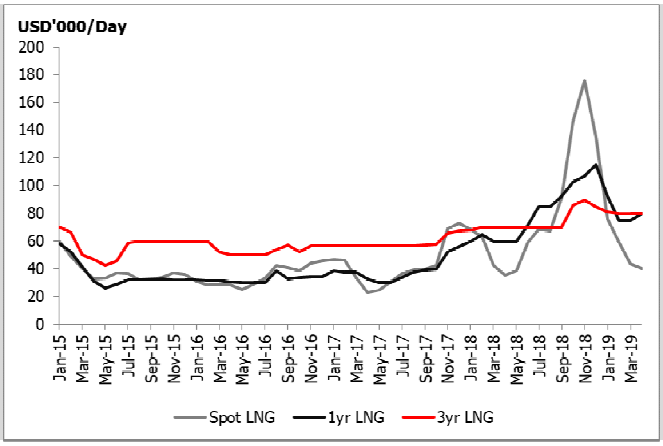
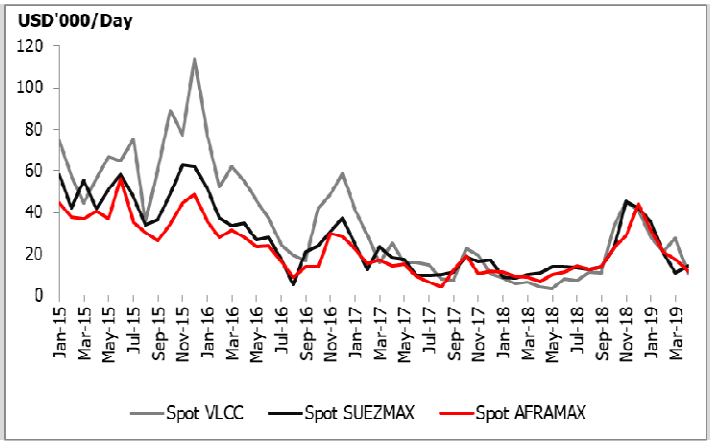


Figure 2: Spot Petroleum tanker rates (US$'000/day)



Source: Company, Ship Brokers' Reports, MIDFR

INVESTMENT STATISTICS

FYE Dec	FY16	FY17	FY18	FY19F	FY20F
Revenue (RM' m)	9,597.2	10,068.2	8,780.3	9,558.5	9,963.7
EBIT (RM' m)	3,011.6	2,172.1	1,605.8	2,041.6	2,069.3
Pretax Profit (RM' m)	2,814.0	2,003.6	1,344.1	1,792.1	1,881.3
Net Profit (RM' m)	2,793.3	1,990.7	1,284.3	1,713.3	1,798.5
Normalised Profit (RM'm)	1,883.0	2,788.9	1,495.6	1,713.3	1,798.5
EPS (sen)	42.2	62.5	28.8	38.4	40.3
EPS growth (%)	-39.2	48.1	-35.5	33.4	5.0
PER (x)	15.5	10.4	22.7	17.0	16.2
Net Dividend (sen)	30.0	30.0	30.0	30.0	30.0
Net Dividend Yield (%)	4.6	4.6	4.6	4.6	4.6

Source: MIDFR, Company

DAILY PRICE CHART



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Source: Bloomberg

MISC BERHAD: 1QFY19 RESULTS SUMMARY

All in RM'm unless stated otherwise	Quarterly Results					*Comments*
FYE Dec	***1QFY19***	***4QFY18***	***1QFY18***	***%QoQ***	***%YoY***	
Revenue	2277.7	2388.5	2020.8	-4.6	12.7	Higher operating vessels and better petroleum freight rates
COGS	(1517.8)	(1681.8)	(1456.6)	-9.8	4.2	
Gross profit	759.9	706.7	564.2	7.5	34.7	
Other income	87.2	92.5	65.8	-5.7	32.5	
SG&A	(255.2)	(417.8)	(246.6)	-38.9	3.5	
Operating profit	591.9	381.4	383.4	55.2	54.4	
Finance Cost	(134.2)	(109.5)	(75.7)	22.6	77.3	
Assoc. & JV Contribution	43.1	160.9	12.6	-73.2	>100	
Exceptional gain/(loss)	41.2	(77.5)	(1.1)	>100	->100	
Profit before tax	542.0	355.3	319.2	52.5	69.8	
Taxation	(26.0)	(28.4)	(10.2)	-8.5	>100	
PATAMI	510.5	338.7	310.6	50.7	64.4	
Normalized PATAMI	479.6	492.3	324.2	-2.6	47.9	

OPERATING SUMMARY (USD'm)

Segmental Revenue	***1QFY19***	***4QFY18***	***1QFY18***	***%QoQ***	***%YoY***	***Comments***
LNG	152.8	134.1	148.9	13.9	2.6	Higher operating vessel
Petroleum	286.7	307.9	248.7	-6.9	15.3	Higher freight rate
Offshore	66.0	65.4	75.1	0.9	-12.1	Absence of construction revenue of FSO Benchamas 2
Heavy Engineering	49.6	65.4	45.8	-24.2	8.3	Timing difference of revenue and profit recognition
Total	555.1	572.8	518.5	-3.1	7.1	
Segmental PBT	***1QFY19***	***4QFY18***	***1QFY18***	***%QoQ***	***%YoY***	***Comments***
LNG	79.9	28.8	65.3	>100	22.4	
Petroleum	18.0	0.9	(18.4)	>100	>100	
Offshore	32.7	59.0	32.4	-44.6	0.9	
Heavy Engineering	(7.2)	(6.2)	(6.6)	-16.1	-9.1	
Total	123.4	82.5	72.7	49.6	69.7	

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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.