2QFY20 Results Review (Above) | Friday, 14 August 2020

MISC Berhad

(3816 | MISC MK) Main | Transportation & Logistics

Maintain Trading BUY

Reduced Target Price: RM8.20

(Previously was RM8.41)

So far, MISC is resilient.

- **2QY20 bodes well for MISC**
- **Still a beneficiary of floating storage demand**
- **Management is focused on time charter**
- **Heavy Engineering is another casualty of COVID-19**
- **Going forward, the outlook for spot rates of petroleum tankers is downhill**
- **Trim FY20E/FY21F/FY22F earnings estimates**
- **Maintain Trading Buy with TP of RM8.20 per share**

2QY20 bodes well for MISC. In 2QFY20, MISC Berhad (MISC) reported a profit after tax of RM186m. After excluding exceptional items such as impairment loss and asset disposal, the normalised profit was RM478.6m (+17.0%yoy). This exceeded our core and consensus' net profit estimate by 7.0% and 12.4% respectively. The positive surprise came on the back of higher revenue recorded from LNG and Petroleum segment (+5.2%yoy and +9.8%yoy) and lower than expected operating cost (S&GA at -17.9%yoy) during the quarter under review.

No dry-docking for LNG boost profitability. The revenue and normalised PBT of the LNG segment in 2QFY20 both increased by +5.2%yoy and +10.5%yoy respectively. The growth in revenue and PBT was mainly attributable to higher earning days following no dry-docking activities in the current quarter. As a result, the impact of softening freight rates for LNG vessels were muted.

Still a beneficiary of floating storage demand. The petroleum shipping segment recorded a PBT which was almost +600%yoy higher in 2QFY20 continuing the exceptional PBT result from 1Q20 (~+300%yoy). However, we believe that this exceptional level will not sustain going forward. This is evidenced from the declining revenue and PBT on QoQ basis for MISC's petroleum segment (-11.2% and -40.0%). Furthermore, petroleum tanker spot rates are on declining trend for the past few months, strongly indicating return to normalcy in the horizon.

Management is focused on time charter. We like the continued commitment of MISC on focusing to increase its exposure on time charter rates in comparison to the volatile nature of spot rates. To note, in 2Q20, the ratio of time charter to spot, by vessel types, was at 96:4, 91:9 and 71:29 (VLCC, Suezmax, Aframax). We understand the trade-off for the continued prudence is that MISC's will potentially miss out the surge in rates and the revenue spike, but we believe this is the right step as time charter rates are climbing steadily for petroleum tankers, inching closer to the level of spot rates.

Heavy Engineering is another casualty of Covid-19. For the 2Q20, Heavy Engineering segment record a dismal PBT of -RM100.2m (<-100%yoy and %qoq). This poor performance was the consequences of lower revenue from on-going heavy engineering projects and lower number of secured vessels due to the yard shutdown during MCO period hence restricting the docking of international clients' vessels into the yard. Strong rebound in business activities and good cost management will be crucial to ensure minimal drag on MISC's bottom line.

RETURN STATISTICS	
Price @ 13th May 2020 (RM)	7.88
Expected share price return (%)	+6.73
Expected dividend yield (%)	+3.80
Expected total return (%)	+10.53

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	1,556.64
Syariah compliant	Yes
Issue shares (m)	4463.75
Estimated free float (%)	21.96
Market Capitalisation (RM'm)	35,129.68
52-wk price range	RM6.52 - RM9.37
Beta vs FBM KLCI (x)	0.68
Monthly velocity (%)	0.09
Monthly volatility (%)	6.35
3-mth average daily volume (m)	3.32
3-mth average daily value (RM'm)	26.78
Top Shareholders (%)	
Petroliam Nasional Bhd	57.56
Employees Provident Fund	9.10
PNB Associated Funds	4.23

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Outlook for tanker rates in the medium term. In our opinion, petroleum tankers rates will likely normalise. We note that on the recent of report from EIA, that US domestic crude supplies fell for a third week in a row, as of August 7, as OPEC+ and non-OPEC countries are committing on the production cut. However, on the demand side, EIA also revised their oil demands forecast further downwards, from 7.9 mil bbl/day drop to a gloomy 8.1 mil bbl/day. Because of this, we opine that petroleum tankers rates will face downward pressure on lukewarm demand coupled with the waning interest in floating storage as oil inventories are drawn down, medium term. Near term, we do not discount on the volatility of tanker rates will continue to whipsaw and MISC's to continue to be one of the beneficiaries of such circumstances.

Figure 1: Crude Production vs Floating Storage

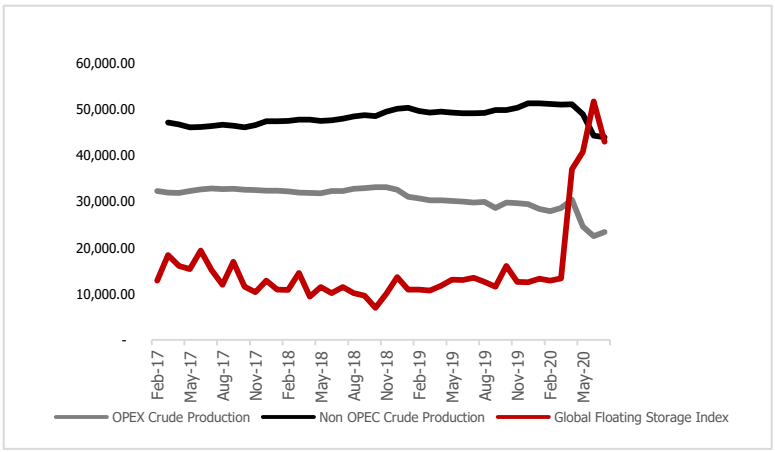
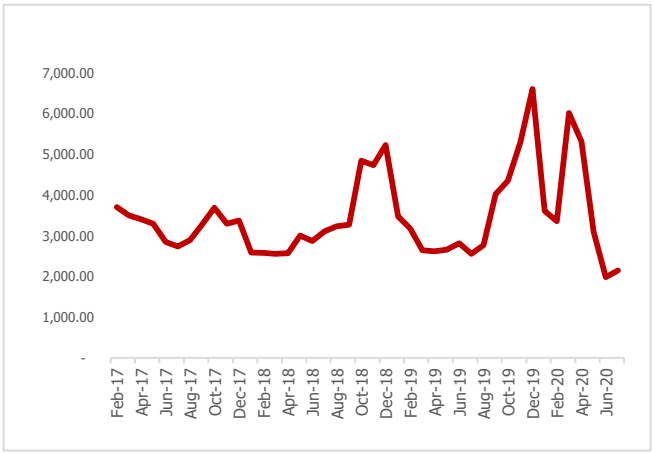


Figure 2: BE Dirty Tanker Index



Sources: Bloomberg, EIA, MIDF

Earnings estimates. Despite earnings exceeded our expectation, we exercise cautious optimism on the prospects of MISC going forward. We trim our earnings estimate for FY20E/FY21F/FY22F by -24.0%/-15.0%/-8.0%. This is to take into account on our view of softening LNG and petroleum tanker moving forward. We remain hopeful on meaningful recovery of oil market dynamics, improving demand vis-a-vis lower crude production for FY21 and FY22. 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 the latter part 2HFY20.

Target price. Our TP is derived by pegging our FY21 book value per share to a 1.0x price-to-book value which is its five-year average at **RM8.20 per share.**

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. 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. While we expect tanker rates to normalise, the time charter contracts will provide a shield to MISC's earnings. Therefore, we are maintaining our **Trading BUY** call on MISC. Risks to MISC are: (i) further downward movement of tanker rates and; (ii) lack of demand for floating storage.

INVESTMENT STATISTICS

FYE Dec	2018A	2019A	2020E	2021F	2022F
Revenue (RM'm)	8,780.3	8,962.7	10,457.4	11,144.4	11,791.6
EBIT (RM'm)	1,333.5	1,929.2	2,432.0	2,728.0	3,034.7
Pretax Profit (RM'm)	1,344.1	1,512.3	2,305.0	2,678.0	2,814.7
PATAMI	1,311.5	1,426.3	1,664.2	2,162.5	2,460.1
Core PATAMI (RM'm)	1,495.6	1,673.7	1,664.2	2,162.5	2,460.1
Core EPS (sen)	33.5	37.5	37.3	48.4	55.1
Core EPS growth (%)	-46.4	11.9	-0.6	29.9	13.8
PER(x)	23.6	21.1	21.2	16.3	14.3

MISC: 2QFY20 RESULTS SUMMARY

All in RM'm unless stated	Quarterly Results				
FYE Dec	***2QFY20***	***1QFY20***	***2QFY19***	***%QoQ***	***%YoY***
Revenue	2,186.3	2,513.8	2,161.7	-13.0	1.1
COGS	(1,401.1)	(1,505.7)	(1,511.3)	-6.9	-7.3
Gross profit	785.2	1,008.1	650.4	-22.1	20.7
Other income	1.4	135.2	57.5	<-100	<-100
SG&A	(263.7)	(298.2)	(223.6)	-11.6	17.9
Operating profit	522.9	845.1	484.3	-38.1	8.0
Finance Cost	(100.5)	(95.8)	(115.6)	4.9	-13.1
Assoc. & JV Contribution	89.7	89.7	101.5	0.0	-11.6
Exceptional gain/(loss)	(284.4)	(1,984.4)	(51.1)	-85.7	>100
Profit before tax	227.7	(1,145.4)	419.1	>100	-45.7
Taxation	(21.7)	(5.6)	(17.2)	<-100	26.2
PATAMI	206.0	(1,156.8)	249.9	>100	-17.6
Normalized PATAMI	478.6	765.9	409.2	-37.5	17.0

OPERATING SUMMARY

Segmental revenue	***2QFY20***	***1QFY20***	***2QFY19***	***%QoQ***	***%YoY***
LNG	692.0	695.9	657.9	-0.6	5.2
Petroleum	1090.1	1228.0	992.5	-11.2	9.8
Offshore	230.8	238.1	258.8	-3.1	-10.8
Heavy Engineering	155.2	346.5	277.0	-55.2	-44.0
Total	2186.3	2513.8	2161.7	-13.0	1.1
Segmental PBT	***2QFY20***	***1QFY20***	***2QFY19***	***%QoQ***	***%YoY***
LNG	352.5	361.7	318.9	-2.5	10.5
Petroleum	201.8	336.5	33.1	-40.0	>100
Offshore	134.3	160.2	139.6	-16.2	-3.8
Heavy Engineering	(100.2)	5.6	(8.6)	<-100	<-100
Total	588.4	864.0	483.0	-31.9	21.8

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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.