07 August 2014 | 2QFY14 Results Review

MISC Bhd

Petroleum segment returns to the red

***Maintain* NEUTRAL**

***Revised* Target Price (TP): RM6.53**
(previously RM6.21)

INVESTMENT HIGHLIGHTS

- **Earnings within expectations; net profit lifted by LNG and Offshore divisions but partly offset by Heavy Engineering, Petroleum and Chemical tanker segments.**
- **4 sen interim dividend declared in the quarter.**
- **Reiterate NEUTRAL with revised TP of RM6.53 as we roll forward our Sum-of-Parts valuation to FY15.**

Earnings within expectations. MISC's 2Q14 core profit increased +25.7%yoy to RM336m. Core profit for the cumulative 1H14 period grew +39%yoy to RM822m, making up 46% and 48% of ours and consensus' full year estimates respectively. Despite the shortfall, we deem earnings as being in line with our expectations due to seasonal factors.

1H14 earnings dragged by Heavy Engineering and Chemicals. 1H14 earnings growth was due to higher charter days for the LNG segment and better Petroleum freight rate but were moderated by the underperformance of the Heavy Engineering and Chemical tanker divisions.

Topline lifted by Heavy Engineering. The 2Q14 topline rose 11%yoy to RM2.54b in tandem with the early progress in projects undertaken by the Heavy Engineering division and improvement in LNG and Petroleum segments. Nonetheless, the smaller operating fleet size in Chemical segment limited revenue growth.

Higher earnings days in LNG segment. The LNG 2Q14's PBT grew +14.7%yoy to USD126.7m, driven by higher earnings days and upward revision in hire rates on the back of higher OPEX. The outlook for LNG shipping rates remains fragile due to possible higher tonnage supply and resumption of Japan's nuclear power reactors this year.

Petroleum segment swung into losses. After posting pretax profit of USD11m in 1Q14, the Petroleum segment recorded a pretax loss of USD31m in 2Q14. As we expected, this was due to the freight rates normalising. Recall that spot VLCC rate in 1Q14 surged to c.USD30-40k/d, highest since 3Q08, due to combination of harsh winter in US and China's record high crude stockpiling then. The average VLCC rate for the Arabian Gulf-Far East routes in 2Q14 fell -46%qoq to USD18.2k/d. We think worsening political unrest in Middle East may support freight rates towards end of 2014. Two Aframax tankers were sold in 2Q14.

Shrinking fleet in Chemical division. The group also sold another three Chemical tankers and recognised a disposal loss of USD14.7m in 2Q14. As outlook for Chemical tanker freight rates remain fragile, we believe the reduced fleet size would lead to lower losses going forward.

Heavy engineering contributed lower profit. Despite the >25%yoy increase in 2Q14 segmental revenue, the segmental PBT declined 56%yoy to USD7.7m mainly due to projects nearing completion and job replenishment remains low. The disproportionate recognition method between revenue and profit affected the performance in its heavy engineering segment in this quarter.

RETURN STATS	
Price (6 August 2014)	RM6.73
Target Price	RM6.53
Expected Share Price Return	-3.0%
Expected Dividend Yield	+2.3%
Expected Total Return	**-0.7%**

STOCK INFO	
KLCI	1,869.92
Bursa / Bloomberg	3816 / MISC MK
Board / Sector	Main/ Trading Services
Syariah Compliant	Yes
Issued shares (mil)	4,463.8
Par Value (RM)	1.00
Market cap. (RM'm)	30,041.3
Price over NA	1.16x
52-wk price Range	RM4.46 – RM7.10
Beta (against KLCI)	0.99
3-mth Avg Daily Vol	2..07m
3-mth Avg Daily Value	RM13.3m
Major Shareholders	
Petronas	62.67%
EPF	7.91%
PNB	6.04%

KINDLY REFER TO THE LAST PAGE OF THIS PUBLICATION FOR IMPORTANT DISCLOSURES

INVESTMENT STATISTICS

FYE Dec	FY13	FY14F	FY15F	FY16F
Revenue (RM'm)	8,971.8	8,212.1	7,982.7	8,089.7
EBIT (RM'm)	1,782.7	1,274.6	1,379.0	1,471.6
Pretax Profit (RM'm)	2,227.7	1,740.6	1,872.0	1,981.6
Core Profit (RM'm)	1,612.8	1,715.6	1,822.0	1,901.6
Core EPS (sen)	36.1	38.4	40.8	42.6
Core EPS growth (%)	92.2	6.4	6.2	4.4
Core PER(x)	17.7	16.7	15.7	15.0
Net Dividend (sen)	5.0	12.0	15.0	21.0
Net Dividend Yield (%)	0.8	1.9	2.3	3.3

Source: Company, Forecasts by MIDFR

Listing of VTTI joint venture. In 2Q14, the jointly owned VTTI Energy Partners between MISC and VITOL went for IPO worth USD350m in the NYSE. The IPO exercise would crystallise the hidden value of VTTI and enhance MISC's cash flow in 3Q14. The 2Q14's shared profit from VTTI's tank terminal business declined to USD5.6m (-22%yoy, -35.6%qoq) because of lower throughput and recognition of IPO listing expense.

Remain NEUTRAL with revised TP of RM6.53. We lower our FY14-15 earnings estimates by -5% and -9.5% respectively to reflect the poor performance of the heavy engineering and tank terminals businesses. Although the long term contracts in LNG and Offshore divisions continue to provide stability to MISC's earnings, we expect earnings drag from the Petroleum and Chemical tankers to partially offset this. However, we believe earnings drag from the Petroleum and Chemical tankers to ease going forward with the recovery in freight rates and reduced fleet size. As such, we reiterate our NEUTRAL stance on MISC. We revise our TP on MISC to RM6.53 (from RM6.21) as we roll forward our SOP valuation to FY15.

SUM-OF-PARTS VALUATION

Segments	FY15 Earnings (RM 'm)	Value/share (RM)	Valuation method
LNG	1,307.5	3.81	13x FY15 PER
Offshore	573.5	1.80	14x FY15 PER
Heavy Engineering	126.3	0.28	10x FY15 PER
Tank Terminal	137.6	0.28	9x FY15 PER
	Book Value/share		
Petroleum	1.20	1.20	1.0x FY15 P/BV
Chemical	0.25	0.25	1.0x FY15 P/BV
	RM 'm		
Less: Net debt	4,845.0	1.09	
TOTAL		6.53	

Source: Company, MIDFR

MISC: 2QFY14 RESULTS SUMMARY

*All in **RM'm** unless stated otherwise*	Quarterly Results			Cumulative		Comments
FYE Dec	***2Q14***	***%YoY***	***%QoQ***	***FY14***	***%YoY***	
Revenue	2,538.6	11.1%	10.8%	4,829.2	3.5%	Higher by early revenue recognition in Heavy Engineering segment
COGS	(1,935.4)	-5.8%	-22.9%	(3,510.2)	4.8%	
Gross Profit	603.2	32.6%	-15.7%	1,319.0	35.0%	
Other operating income	22.5	-82.7%	-48.5%	66.1	-66.7%	
SG&A	(243.4)	-1.3%	4.6%	(498.5)	-14.4%	
Operating Profit	382.3	10.9%	-24.2%	886.6	19.9%	
Finance cost	(95.4)	22.8%	0.3%	(191.2)	4.0%	Refinancing of USD700m borrowing at lower financing rate
Assoc.& JV Contribution	105.6	24.3%	-11.5%	224.9	57.6%	
Exceptional gain/(loss)	(47.9)	-242.5%	#DIV/0!	(47.9)	<-100%	Disposal loss in sale of three B-Class Chemical tankers
Pre-tax profit	344.6	1.4%	-34.7%	872.4	25.6%	
tax	(25.5)	-100.5%	-59.5%	(41.6)	-61.9%	
Net Profit	288.1	-4.3%	-40.8%	774.5	28.8%	
Core Net Profit	336.0	25.7%	-30.9%	822.4	39.4%	Mainly driven by higher earnings in LNG, and Offshore divisions
Segmental PBT, USD'm						
LNG	126.7	14.7%	4.8%	247.6	14.7%	Boosted by higher earning days and upward revision in OPEX hire rates.
Petroleum	(31.0)	38.6%	-381.8%	(20.0)	76.9%	Softening in quarterly freight rate
Chemical	(14.7)	-2.1%	-15.7%	(27.4)	-12.8%	Continual weakening in freight rate but moderated by smaller fleet size
Offshore	32.5	0.3%	10.5%	61.9	14.6%	Higher share profit from FPSO Espirito Santo and FPSO Brasil
Heavy engineering	7.7	-56.0%	-27.4%	18.3	-48.6%	Early progress in current HE projects
Tank Terminal	5.6	-22.2%	-35.6%	14.3	-17.8%	Lower profit due to IPO fee and lower throughput
Liner Logistics	0.3	-70.0%	160.0%	(0.2)	<-100%	

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	*Negative* 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	
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.