

Company Guide

Muhibbah Engineering

Edition 1 Version 1 | Bloomberg: MUHI MK | Reuters: MUHI.KL

Refer to important disclosures at the end of this report

Malaysia Equity Research

21 Jul 2015

BUY

Last Traded Price: RM2.27 KLCI : 1,724.13

Price Target : 12-Month RM 3.40 (50%) (Prev RM 3.50)

Shariah Compliant : Yes

Potential Catalyst: Win RAPID, port and other infrastructure projects

Where we differ: Our earnings are in line but TP is more aggressive as we believe Muhibbah deserves premium valuation

Analyst

CHONG Tjen San, CFA +603 2604 3972 tjensan@alliancedbs.com

Price Relative



Forecasts and Valuation

| FY Dec (RM m) | 2014A | 2015F | 2016F | 2017F |
|----------------------|-------|-------|-------|-------|
| Revenue | 1,693 | 1,709 | 1,770 | 1,793 |
| EBITDA | 159 | 209 | 229 | 257 |
| Pre-tax Profit | 145 | 132 | 148 | 173 |
| Net Profit | 82 | 95 | 106 | 122 |
| Net Pft (Pre Ex.) | 82 | 95 | 106 | 122 |
| EPS (sen) | 19.3 | 22.4 | 25.2 | 28.8 |
| EPS Pre Ex. (sen) | 19.3 | 22.4 | 25.2 | 28.8 |
| EPS Gth (%) | (6) | 16 | 13 | 14 |
| EPS Gth Pre Ex (%) | (6) | 16 | 13 | 14 |
| Diluted EPS (sen) | 19.3 | 22.4 | 25.2 | 28.8 |
| Net DPS (sen) | 4.5 | 4.5 | 5.0 | 5.8 |
| BV Per Share (sen) | 152.4 | 169.2 | 189.9 | 213.7 |
| PE (X) | 11.8 | 10.1 | 9.0 | 7.9 |
| PE Pre Ex. (X) | 11.8 | 10.1 | 9.0 | 7.9 |
| P/Cash Flow (X) | nm | 3.9 | 8.1 | 6.9 |
| EV/EBITDA (X) | 11.4 | 7.9 | 7.1 | 6.1 |
| Net Div Yield (%) | 2.0 | 2.0 | 2.2 | 2.5 |
| P/Book Value (X) | 1.5 | 1.3 | 1.2 | 1.1 |
| Net Debt/Equity (X) | 0.7 | 0.5 | 0.4 | 0.3 |
| ROAE (%) | 13.5 | 13.9 | 14.0 | 14.3 |
| Earnings Rev (%): | | (2) | 0 | (1) |
| Consensus EPS (sen): | | 23.0 | 24.5 | 28.7 |
| Other Broker Recs: | | B: 6 | S: 1 | H: 0 |

Source of all data: Company, AllianceDBS, Bloomberg Finance L.P

SCARCITY PREMIUM FOR INFRA PROXY

Scarcity premium

Muhibbah is an ideal proxy to the 11th Malaysian Plan given its expertise in three core areas: i) civil engineering; ii) marine-based construction, and iii) offshore and onshore fabrication works, where its Petronas license is an advantage. Other contractors do not have this combination to compete effectively in the competitive civil engineering space.

Cash cow: Cambodia airport concession

Siam Reap and Phnom Penh airports will double capacity to 12m passengers. Passenger arrivals reached 5.7m in 2014 (+12% y-o-y) led by a recovery in Chinese tourists (20% of total; +22% y-o-y). 1Q15 volume grew another 12% to 1.9m passengers. We estimate its 21% stake in the Cambodia airport concession is worth RM580m (DCF, WACC 10%, RM/USD 3.65, and passenger traffic +5% p.a. until 2040), which is already 63% of its market capitalisation. Revenues are also in USD.

Favco reinventing itself

The crane division under Favelle Favco is seeing its strongest orderbook currently, at RM1bn. 60-70% of Favco's revenue is in USD while 80% of the cost of cranes - manufactured at its plant in Senawang - is in ringgit. There is slowing demand for cranes by the offshore oil & gas industry, but this could be offset by demand for tower cranes and higher after-sales revenues.

Valuation:

Muhibbah is a BUY with a RM3.40 TP. We have moved our valuation methodology back to SOP as we think it better reflects its diversified business while also capturing its cash generating Cambodian concession.

Key Risks to Our View:

Its infrastructure division is the missing link now with orderbook at only RM1bn (1-year visibility). The pipeline of new projects look healthy, but timing of contract wins is difficult to predict and could lead to earnings downgrades. Another potential risk is non-renewal of its Roadcare concession and unfavourable outcome of the adjudication under the Building & Construction Industry Payment Act for the Wiggin Island project.

At A Glance

| | |
|---------------------------|-------------|
| Issued Capital (m shrs) | 468 |
| Mkt. Cap (RMm/US\$m) | 1,062 / 280 |
| Major Shareholders | |
| Mac Ngan Boon (%) | 22.1 |
| Lembaga Tabung Haji (%) | 9.6 |
| Ooi Sen Eng (%) | 3.2 |
| Free Float (%) | 60.7 |
| 3m Avg. Daily Val (US\$m) | 0.9 |

ICB Industry : Industrials / Construction & Materials

CRITICAL DATA POINTS TO WATCH

Earnings Drivers:

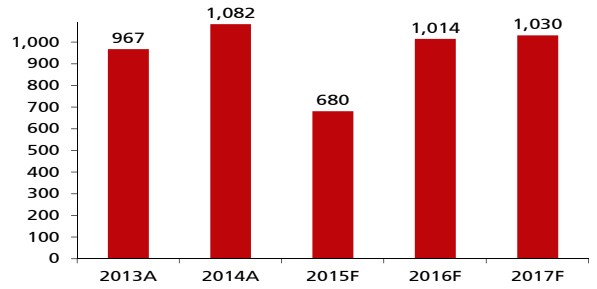
Stronger earnings growth ahead. We expect Muhibbah to deliver better earnings growth of 16% in FY15. 1Q15 started on a strong note with all divisions – except shipyard - recording better profitability y-o-y and q-o-q. The construction division booked RM11m pretax profit in 1Q15 (vs RM10m in 1Q14, RM6m in 4Q14) on the back of higher margin of 4.8% (vs 3.8% in 1Q14, 1.7% in 4Q14). 1Q15 pretax profit for the Cambodia airport concessions grew 24% y-o-y to RM18m, driven by strong traffic volume growth (+12% y-o-y) at the airports to 1.9m passengers, and a stronger USD. The crane business under Favelle Favco booked strong pretax profit growth of 75% y-o-y to RM30m driven by a peak orderbook of RM1bn. The shipyard segment pretax profit was only RM0.6m in 1Q15 (vs RM6m in 1Q14, RM17m in 4Q14) as the RM219m Jasa Merin contract is at its tail end.

Infrastructure division most promising. Muhibbah believes the infrastructure sector is on a multi-year upcycle with potentially RM140bn worth of projects up for grabs. Also, raw material costs are more benign now with cement and steel prices 5% and 15% cheaper y-o-y, respectively. Muhibbah will be bidding for major projects such as RAPID, MRT Line 2 and WCE, and is quietly confident of clinching other marine-based projects. YTD wins amount to RM431m with recent Northport win, and it should close the year better than the RM504m wins in 2014.

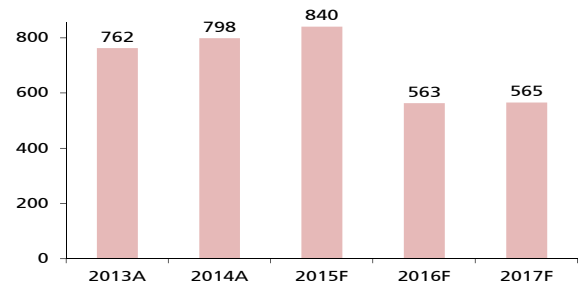
Cambodia airports to double capacity. Effective July, the Siam Reap and Phnom Penh airports will double their existing capacity to 12m passengers. The US\$85m capex is financed by only one year of operating cashflow, which suggests the airports are cash cows. Passenger arrivals reached 5.7m in 2014 (+12 % y-o-y) led by a recovery in Chinese tourists (20% of total; +22% y-o-y). We estimate its 21% stake is worth RM580m (DCF, WACC 10%, RM/USD 3.65, and average passenger growth of 5% p.a. until 2040).

Favco capitalising on other revenue streams. Favco has been receiving increasing orders in the US for tower cranes, and is beefing up its maintenance division (c.10% of revenues). This should cushion potentially softer orders for oil and gas cranes. We still expect a record year for Favco as it runs down its high-margin peak RM1bn orderbook. It is also exploring supplying cranes to RAPID.

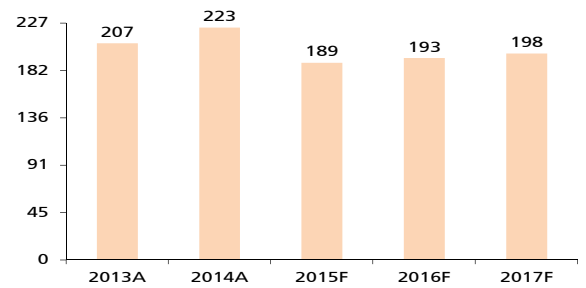
Construction revenue contribution (RMm)



Cranes revenue contribution (RMm)



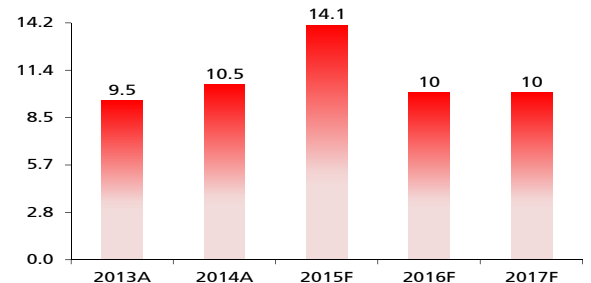
Shipyard revenue contribution (RMm)



Margins for construction (%)



Margins for cranes (%)



Source: Company, AllianceDBS

Balance Sheet:

Needs bigger balance sheet. Muhibbah’s shareholder’s funds as at 31 December 2014 is RM861m (including minority interest). We understand the company is aiming to strengthen this further to capitalize on larger contract flows from Petronas. This may be via a private placement or rights issue. Net gearing is still manageable at 0.7x, while its cash generating Cambodia airport concession should provide adequate cash flow.

Share Price Drivers:

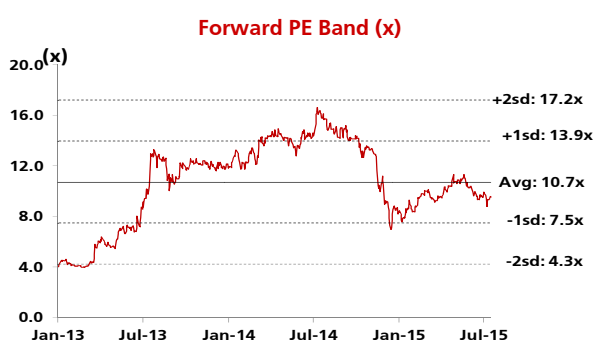
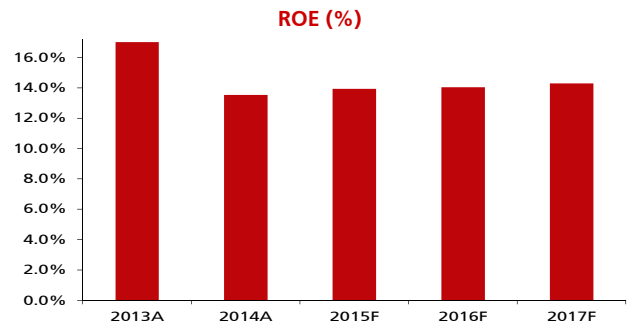
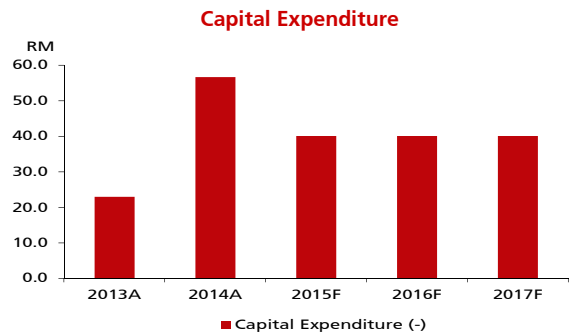
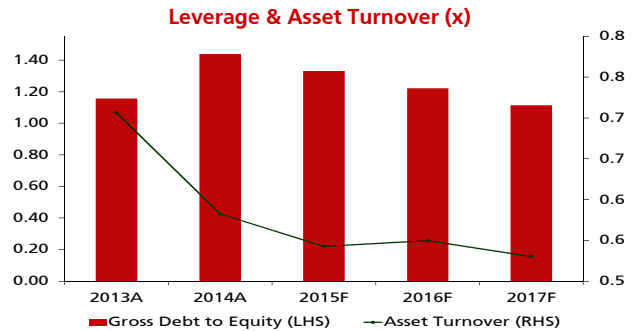
Complete proxy to Malaysia infrastructure. Muhibbah is a complete proxy to the Malaysian infrastructure space because of its experience in bread-and-butter civil engineering works, as well as niche marine infrastructure and onshore and offshore fabrication works. Hence, we expect the company to clinch works from RAPID, MRT Line 2, LRT 3, West Coast Expressway and port projects.

Capitalising on Petronas Fabrication License. Muhibbah was awarded the much sought after Petronas license to take on offshore facilities construction and major onshore fabrication works. This suggests better opportunities to bag more Petronas-related jobs (downstream works). It has a 57-acre fabrication yard with a total capacity of 25,000 MT per year, making the third largest of the Petronas licensed fabricator.

Completed landmark projects. Muhibbah has an impressive track record having completed a list of landmark projects locally and abroad. Of significance is the LNG Regasification project for Petronas Gas in Melaka and South Klang Valley Expressway.

COMPANY BACKGROUND

Muhibbah is primarily involved in construction, fabrication of cranes and shipbuilding. These 3 core divisions cater largely for the O&G sector. It also holds a 21% associate stake in 2 concessions, namely the Cambodian airports and Federal road maintenance in Malaysia.



Source: Company, AllianceDBS

Muhibbah Engineering

Key Assumptions

| FY Dec | 2013A | 2014A | 2015F | 2016F | 2017F |
|--------------------------------|-------|-------|-------|---------|---------|
| Construction revenue | | | 680.3 | 1,014.0 | 1,030.1 |
| Cranes revenue contribution | | | 839.9 | 562.5 | 565.0 |
| Shipyards revenue contribution | | | 188.6 | 193.2 | 197.5 |
| Margins for construction | | | 3.1 | 3.0 | 3.0 |

Segmental Breakdown

| FY Dec | 2013A | 2014A | 2015F | 2016F | 2017F |
|------------------------|--------------|--------------|--------------|--------------|--------------|
| Revenues (RM m) | | | | | |
| Construction | 967 | 1,082 | 680 | 1,014 | 1,030 |
| Cranes | 762 | 798 | 840 | 563 | 565 |
| Ships | 207 | 223 | 189 | 193 | 198 |
| Others | 0 | (410) | 0 | 0 | 0 |
| Total | 1,936 | 1,693 | 1,709 | 1,770 | 1,793 |

Income Statement (RM m)

| FY Dec | 2013A | 2014A | 2015F | 2016F | 2017F |
|-----------------------------|------------|------------|------------|------------|------------|
| Revenue | 1,936 | 1,693 | 1,709 | 1,770 | 1,793 |
| Cost of Goods Sold | (1,723) | (1,583) | (1,490) | (1,540) | (1,536) |
| Gross Profit | 213 | 110 | 219 | 230 | 256 |
| Other Opng (Exp)/Inc | (108) | 1 | (119) | (116) | (119) |
| Operating Profit | 105 | 111 | 99 | 114 | 137 |
| Other Non Opng (Exp)/Inc | 0 | 0 | 0 | 0 | 0 |
| Associates & JV Inc | 47 | 48 | 51 | 54 | 57 |
| Net Interest (Exp)/Inc | (19) | (14) | (18) | (20) | (21) |
| Exceptional Gain/(Loss) | 0 | 0 | 0 | 0 | 0 |
| Pre-tax Profit | 133 | 145 | 132 | 148 | 173 |
| Tax | (16) | (34) | (16) | (19) | (23) |
| Minority Interest | (30) | (30) | (21) | (23) | (28) |
| Preference Dividend | 0 | 0 | 0 | 0 | 0 |
| Net Profit | 86 | 82 | 95 | 106 | 122 |
| Net Profit before Except. | 86 | 82 | 95 | 106 | 122 |
| EBITDA | 206 | 159 | 209 | 229 | 257 |
| Growth | | | | | |
| Revenue Gth (%) | (26.2) | (12.6) | 0.9 | 3.6 | 1.3 |
| EBITDA Gth (%) | (23.0) | (22.7) | 31.7 | 9.2 | 12.3 |
| Opg Profit Gth (%) | (40.1) | 5.8 | (10.6) | 14.5 | 20.4 |
| Net Profit Gth (Pre-ex) (%) | (43.1) | (5.6) | 15.9 | 12.6 | 14.4 |
| Margins & Ratio | | | | | |
| Gross Margins (%) | 11.0 | 6.5 | 12.8 | 13.0 | 14.3 |
| Opg Profit Margin (%) | 5.4 | 6.6 | 5.8 | 6.4 | 7.6 |
| Net Profit Margin (%) | 4.5 | 4.8 | 5.5 | 6.0 | 6.8 |
| ROAE (%) | 17.0 | 13.5 | 13.9 | 14.0 | 14.3 |
| ROA (%) | 3.2 | 2.8 | 3.0 | 3.3 | 3.6 |
| ROCE (%) | 3.9 | 3.5 | 3.4 | 3.7 | 4.0 |
| Div Payout Ratio (%) | 21.9 | 23.4 | 20.0 | 20.0 | 20.0 |
| Net Interest Cover (x) | 5.5 | 8.1 | 5.5 | 5.8 | 6.5 |

Source: Company, AllianceDBS

Quarterly / Interim Income Statement (RM m)

| FY Dec | 4Q2013 | 1Q2014 | 2Q2014 | 3Q2014 | 4Q2014 |
|-------------------------|---------------|---------------|---------------|---------------|---------------|
| Revenue | 632 | 394 | 466 | 376 | 457 |
| Other Oper. (Exp)/Inc | (588) | (378) | (429) | (351) | (424) |
| Operating Profit | 44 | 16 | 37 | 26 | 33 |
| Other Non Opg (Exp)/Inc | 0 | 0 | 0 | 0 | 0 |
| Associates & JV Inc | 12 | 15 | 11 | 5 | 17 |
| Net Interest (Exp)/Inc | (9) | 0 | (3) | (3) | (7) |
| Exceptional Gain/(Loss) | 0 | 0 | 0 | 0 | 0 |
| Pre-tax Profit | 46 | 31 | 45 | 28 | 42 |
| Tax | (9) | (9) | (14) | 0 | (10) |
| Minority Interest | (13) | (2) | (9) | (7) | (11) |
| Net Profit | 25 | 20 | 21 | 20 | 20 |
| Net profit bef Except. | 25 | 20 | 21 | 20 | 20 |
| EBITDA | 68 | 44 | 62 | 45 | 69 |

Growth

| | | | | | |
|-----------------------------|-------|--------|-------|--------|------|
| Revenue Gth (%) | 32.8 | (37.6) | 18.3 | (19.3) | 21.4 |
| EBITDA Gth (%) | 63.1 | (35.7) | 40.6 | (27.5) | 54.0 |
| Opg Profit Gth (%) | 173.3 | (63.4) | 132.3 | (31.1) | 27.5 |
| Net Profit Gth (Pre-ex) (%) | 22.1 | (17.9) | 3.8 | (3.1) | 0.0 |

Margins

| | | | | | |
|------------------------|-----|-----|-----|-----|-----|
| Opg Profit Margins (%) | 6.9 | 4.0 | 7.9 | 6.8 | 7.1 |
| Net Profit Margins (%) | 3.9 | 5.1 | 4.5 | 5.4 | 4.4 |

Balance Sheet (RM m)

| FY Dec | 2013A | 2014A | 2015F | 2016F | 2017F |
|-------------------------------|--------------|--------------|--------------|--------------|--------------|
| Net Fixed Assets | 711 | 725 | 708 | 690 | 670 |
| Invt in Associates & JVs | 190 | 236 | 284 | 335 | 389 |
| Other LT Assets | 30 | 31 | 31 | 31 | 31 |
| Cash & ST Invt | 426 | 601 | 815 | 904 | 1,011 |
| Inventory | 207 | 226 | 163 | 169 | 168 |
| Debtors | 1,077 | 1,334 | 1,124 | 1,164 | 1,179 |
| Other Current Assets | 10 | 13 | 13 | 13 | 13 |
| Total Assets | 2,650 | 3,165 | 3,137 | 3,304 | 3,461 |
| ST Debt | 738 | 1,168 | 1,198 | 1,228 | 1,258 |
| Creditor | 948 | 966 | 816 | 844 | 842 |
| Other Current Liab | 9 | 39 | 39 | 39 | 39 |
| LT Debt | 137 | 69 | 69 | 69 | 69 |
| Other LT Liabilities | 62 | 62 | 62 | 62 | 62 |
| Shareholder's Equity | 563 | 644 | 715 | 803 | 903 |
| Minority Interests | 194 | 217 | 238 | 261 | 288 |
| Total Cap. & Liab. | 2,650 | 3,165 | 3,137 | 3,304 | 3,461 |
| Non-Cash Wkg. Capital | 337 | 567 | 444 | 462 | 479 |
| Net Cash/(Debt) | (449) | (636) | (452) | (393) | (316) |
| Debtors Turn (avg days) | 231.0 | 259.9 | 262.5 | 235.9 | 238.5 |
| Creditors Turn (avg days) | 215.7 | 220.7 | 227.4 | 204.9 | 208.8 |
| Inventory Turn (avg days) | 45.4 | 49.9 | 49.7 | 41.0 | 41.8 |
| Asset Turnover (x) | 0.7 | 0.6 | 0.5 | 0.5 | 0.5 |
| Current Ratio (x) | 1.0 | 1.0 | 1.0 | 1.1 | 1.1 |
| Quick Ratio (x) | 0.9 | 0.9 | 0.9 | 1.0 | 1.0 |
| Net Debt/Equity (X) | 0.6 | 0.7 | 0.5 | 0.4 | 0.3 |
| Net Debt/Equity ex MI (X) | 0.8 | 1.0 | 0.6 | 0.5 | 0.3 |
| Capex to Debt (%) | 2.6 | 4.6 | 3.2 | 3.1 | 3.0 |
| Z-Score (X) | 1.4 | 1.1 | 1.2 | 1.2 | 1.3 |

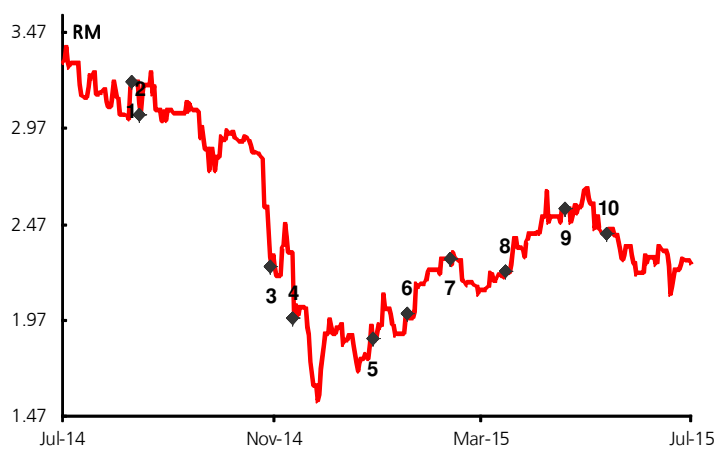
Source: Company, AllianceDBS

Cash Flow Statement (RM m)

| FY Dec | 2013A | 2014A | 2015F | 2016F | 2017F |
|-------------------------|-------------|--------------|-------------|-------------|-------------|
| Pre-Tax Profit | 133 | 145 | 132 | 148 | 173 |
| Dep. & Amort. | 54 | 0 | 59 | 61 | 63 |
| Tax Paid | (16) | (34) | (16) | (19) | (23) |
| Assoc. & JV Inc/(loss) | (47) | (48) | (51) | (54) | (57) |
| Chg in Wkg.Cap. | 223 | (258) | 123 | (18) | (17) |
| Other Operating CF | 21 | 122 | 0 | 0 | 0 |
| Net Operating CF | 368 | (73) | 247 | 118 | 139 |
| Capital Exp.(net) | (23) | (57) | (40) | (40) | (40) |
| Other Invt.(net) | 0 | 0 | 0 | 0 | 0 |
| Invt in Assoc. & JV | (19) | (46) | 0 | 0 | 0 |
| Div from Assoc & JV | 0 | 0 | 0 | 0 | 0 |
| Other Investing CF | 46 | 67 | 0 | 0 | 0 |
| Net Investing CF | 5 | (36) | (40) | (40) | (40) |
| Div Paid | (19) | (46) | 0 | 0 | 0 |
| Chg in Gross Debt | (23) | (57) | (40) | (40) | (40) |
| Capital Issues | 0 | 0 | 0 | 0 | 0 |
| Other Financing CF | 5 | (36) | (40) | (40) | (40) |
| Net Financing CF | (37) | (138) | (80) | (80) | (80) |
| Currency Adjustments | 46 | 67 | 0 | 0 | 0 |
| Chg in Cash | 382 | (180) | 127 | (2) | 19 |
| Opg CFPS (sen) | 34.3 | 43.9 | 29.4 | 32.3 | 36.8 |
| Free CFPS (sen) | 81.6 | (30.6) | 49.1 | 18.5 | 23.4 |

Source: Company, AllianceDBS

Target Price & Ratings History



Note: Share price and Target price are adjusted for corporate actions.

| S.No. | Date | Closing Price | Target Price | Rating |
|-------|-----------|---------------|--------------|--------|
| 1: | 29 Aug 14 | 3.21 | 3.20 | Hold |
| 2: | 03 Sep 14 | 3.04 | 3.20 | Hold |
| 3: | 18 Nov 14 | 2.25 | 3.50 | Buy |
| 4: | 01 Dec 14 | 1.98 | 3.50 | Buy |
| 5: | 16 Jan 15 | 1.87 | 3.50 | Buy |
| 6: | 05 Feb 15 | 2.00 | 3.50 | Buy |
| 7: | 02 Mar 15 | 2.29 | 3.50 | Buy |
| 8: | 03 Apr 15 | 2.22 | 3.50 | Buy |
| 9: | 08 May 15 | 2.55 | 3.50 | Buy |
| 10: | 01 Jun 15 | 2.42 | 3.50 | Buy |

Source: AllianceDBS

DISCLOSURE

Stock rating definitions

| | | |
|--------------|---|--|
| STRONG BUY | - | > 20% total return over the next 3 months, with identifiable share price catalysts within this time frame |
| BUY | - | > 15% total return over the next 12 months for small caps, >10% for large caps |
| HOLD | - | -10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps |
| FULLY VALUED | - | negative total return > -10% over the next 12 months |
| SELL | - | negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame |

Commonly used abbreviations

| | | |
|--|---------------------------|---|
| Adex = advertising expenditure | EPS = earnings per share | PBT = profit before tax |
| bn = billion | EV = enterprise value | P/B = price / book ratio |
| BV = book value | FCF = free cash flow | P/E = price / earnings ratio |
| CF = cash flow | FV = fair value | PEG = P/E ratio to growth ratio |
| CAGR = compounded annual growth rate | FY = financial year | q-o-q = quarter-on-quarter |
| Capex = capital expenditure | m = million | RM = Ringgit |
| CY = calendar year | M-o-m = month-on-month | ROA = return on assets |
| Div yld = dividend yield | NAV = net assets value | ROE = return on equity |
| DCF = discounted cash flow | NM = not meaningful | TP = target price |
| DDM = dividend discount model | NTA = net tangible assets | trn = trillion |
| DPS = dividend per share | NR = not rated | WACC = weighted average cost of capital |
| EBIT = earnings before interest & tax | p.a. = per annum | y-o-y = year-on-year |
| EBITDA = EBIT before depreciation and amortisation | PAT = profit after tax | YTD = year-to-date |

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Wong Ming Tek, Executive Director

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AllianceDBS Research Sdn Bhd (128540 U)
19th Floor, Menara Multi-Purpose, Capital Square, 8 Jalan Munshi Abdullah, 50100 Kuala Lumpur, Malaysia.
Tel.: +603 2604 3333 Fax: +603 2604 3921 email : general@alliancedbs.com