InsiderAsia
by Asia Analytica

2Q FY2016 results update **1 Sept 2016**

Muhibbah Engineering (M) Bhd

- 1H2016 results in line with forecast
- Favco contributions recovers strongly after 1Q2016 dip
- Concessions, RM1.9b orderbook to sustain earnings
- Attractive valuations, maintain BUY

BUY

Share price
RM2.25

Market capitalization
RM1,059 million

Board
Main

Indices
FBM Emas Syariah,

Sector
Construction

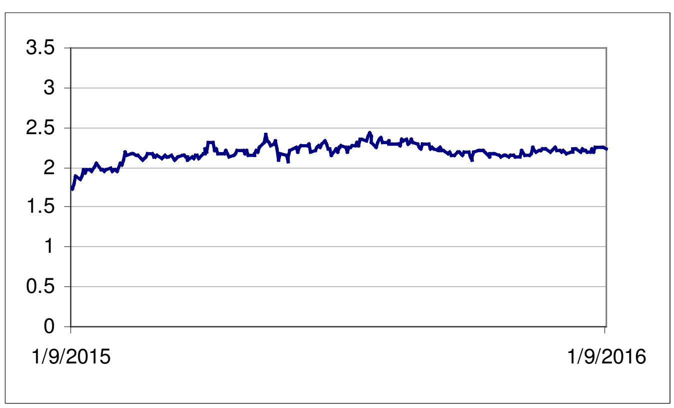
Stock code
5703

By
The Research Team

Key stock statistics	FY Dec15	FY Dec16E
EPS (sen)	18.7	20.1
P/E (x)	12.0	11.2
DPS (sen)	5.0	5.0
NTA/share (RM)	1.75	1.86
Issued capital (mil)	470.6	
52-week price range (RM)	1.79 -2.52	

Major shareholders (%)	
Mac Ngan Boon	20.7%
Lembaga Tabung Haji	9.6%

Share Price Chart



1H FY2016 Results highlights

Year end Dec (RM mil)	1H2016	1H2015	% chg
Turnover	888.1	773.5	14.8
Pre-tax profit	77.1	76.9	0.2
Tax	(16.3)	(18.8)	(13.3)
Minority interests	(10.2)	(15.6)	(34.3)
Net profit	50.6	42.5	18.8
EPS (sen)	10.74	9.52	
Pre-tax profit margin (%)	8.7	9.9	
Net profit margin (%)	5.7	5.5	

Muhibbah Engineering's results for the second quarter and first half of FY Dec 2016 were within our expectations, with 1H2016 net profit of RM50.6 million coming in at 52.3% of our full year forecast of RM98.6 million.

For 2Q2016, Muhibbah posted net profit of RM26.8 million, up 39.2% y-y and 12.9% q-q. For the first half of 2016, net profit rose 18.8% y-y to RM50.6 million, on the back of a 14.8% growth in revenue to RM888.1 million.

The much stronger y-y performance in 2Q2016 was mainly due to the construction division, which has gained traction as more RAPID related projects got underway, as well as the concessions division.

The crane division, Favelle Favco, saw a strong recovery in earnings in 2Q2016 as it suffered a particularly weak 1Q2016 due to the sharp slowdown in the oil and gas industry. Favco supplies about 80-90% of its cranes to the oil & gas industry.

Favco's sales have improved in 2Q2016, with a more substantial recovery in margins as the company restructured its cost base to adapt to the slowdown. For 2Q2016, Favco's net profit increased 20% y-y to RM19.9 million, despite a 16.3% decline in turnover to RM166.2 million. More significantly, net profit surged 75% q-q from RM11.4 million in 1Q2016.

For 1H2016, Muhibbah's after-tax contributions from associates increased 16.9% y-y to RM32.5 million. This reflects its concession business, comprising an effective 21% stake in the three Cambodian airports (Phnom Penh, Siem Reap and Sihanoukville), and a 21% stake in Roadcare (M) Sdn Bhd, which holds a 10-year concession (valid until 2026) for the maintenance of over 7,000 km of federal roads in central peninsular Malaysia.

Muhibbah's order-book stood at RM1.87 billion as at 22 Aug 2016, down slightly from RM2.11 billion in May 2016. Of the order-book, RM1.22 billion are for infrastructure construction works, RM571 million for cranes and RM77 million for the shipyard. Some 67% of the order-book is for jobs in Malaysia.

Outlook and recommendation

We maintain our **BUY** recommendation and forecasts. We continue to like Muhibbah for its attractive valuations, well-diversified earnings base, with medium term earnings visibility backed by its RM1.9 billion order-book.

The company's earnings are now more diversified and less reliant on the cyclical oil and gas industry. A very large proportion is now coming from its sustainable and fast growing Cambodian airport concessions, where income is denominated in USD. The concession business accounted for 53% of Muhibbah's net profit in 1H2016.

We expect Muhibbah's net profit to grow 13.1% to RM96.8 million in 2016 and 9.2% to RM105.7 million in 2017. Post the proposed (but yet to be implemented) placement exercise, EPS is projected at 20.1 sen and 20.4 sen for 2016-2017, respectively. The stock is currently trading on low P/E multiples of 11.2 and 11 times for 2016-2017, respectively.

Outlook for the oil and gas industry remains challenging. Many global industry players are cutting costs and capital spending as a prolonged period of depressed oil prices has started to sap their finances. Crude oil prices continue to gyrate although having rebounded from lows of US$30 to around US$45 per barrel.

In particular, the oil and gas slowdown has affected Favco more than other divisions, as some 80-90% of its cranes are used in the oil & gas industry. On a positive note, Favco has been actively securing new contracts and replenishing its order-book, which has stayed steady at RM571 million, equivalent to a full year of revenue.

Unlike Favco, Muhibbah's infrastructure construction division has been largely unaffected by the oil & gas slowdown. This is due to its focus on the US$27 billion RAPID project in Pengerang, for which contracts have been awarded since mid-2015 and construction is ongoing. The refinery is expected to be completed in 2019.

This mega-project is largely unaffected by Petronas' capex cuts and offers ample opportunities for Muhibbah. Other potential large projects that Muhibbah could tender for include RM35 billion worth of infrastructure projects such as the MRT2 and LRT3, and RM3 billion in port projects.

In June 2016, Muhibbah entered into an agreement with Perbadanan Setiausaha Kerajaan Pahang for the proposed acquisition of a 99-year leasehold land measuring 500 acres in Kuantan, Pahang, for RM26.45 million, or just RM1.21 psf. The land would be developed into the proposed Kuantan Maritime Hub over a period of 10 years. The acquisition provides an opportunity to develop industrial activities for ship building, ship repair works and major fabrication offshore structure in Kuantan.

The land is strategically located about 20km from Kuantan town, and just 5 km from Kuantan Port, which is owned by IJM Corp and Guangxi Beibu.

Meanwhile, the Cambodian airport concession operations are providing steady earnings and a major growth impetus. Earnings are derived in USD and the airports are benefitting from rising passenger traffic and a recently completed expansion exercise.

Arrivals at the three Cambodian airports have grown a robust 13% per year for the last two years, reaching 6.5 million arrivals in 2015. Of these arrivals in 2015, 3.07 million were at the Phnom Penh airport, 3.3 million in Siem Reap airport and 95,000 at the relatively new Sihanoukville airport.

In 1H2016, arrivals into the Cambodian airports rose 5% to 3.41 million passengers, led by a 9% growth in Phnom Penh and 1% in Siem Reap.

Future growth will be underpinned by a recently completed capacity expansion at the two main airports and over time, more arrivals at the southern port and beach city of Sihanoukville as more flights are added.

In March 2016, additional terminal buildings for the Phnom Penh and Siem Reap airports were officially opened. This has doubled the collective annual capacity of its three Cambodian airports from 6 to 12 million passengers.

Profit & Loss Analysis

Year end Dec (RM mil)	2014	2015	2016E	2017E
Turnover	1,733.6	1,599.0	1,660.0	1,645.0
EBITDA	178.8	204.5	181.5	213.2
Depreciation	(55.8)	(55.7)	(57.0)	(60.0)
Associates	49.2	62.2	76.0	84.0
Interest income/(exp)	(28.5)	(42.7)	(42.0)	(40.0)
Pre-tax profit	143.7	168.3	158.5	197.2
Tax	(24.8)	(31.4)	(31.7)	(39.4)
Minorities	(37.3)	(51.3)	(30.0)	(52.0)
Net profit	81.6	85.6	96.8	105.7
Operating margin (%)	10.3	12.8	10.9	13.0
Pre-tax margin (%)	8.3	10.5	9.5	12.0
Net margin (%)	4.7	5.4	5.8	6.4
Effective tax rate (%)	17.3	18.7	20.0	20.0

Per Share Data

Year end Dec	2014	2015	2016E	2017E
EPS (sen)	19.2	18.7	20.1	20.4
P/E (x)	11.7	12.0	11.2	11.0
Dividend (sen)	4.0	5.0	5.0	5.0
Dividend yield (%)	1.8	2.2	2.2	2.2
Payout ratio (%)	21	27	25	24
Book value (RM)	1.50	1.75	1.86	1.89
Price/Book value (x)	1.50	1.28	1.21	1.19
Cashflow/share (sen)	29.2	27.7	22.3	25.8
Price/Cashflow (x)	7.7	8.1	10.1	8.7
Gearing (%) (excluding bills payables)	21	18	16	15
ROE (%)	12.7	10.4	10.8	10.8

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