

Malaysia Company Guide

Muhibbah Engineering

Version10 | Bloomberg: MUHI MK | Reuters: MUHI.KL

Refer to important disclosures at the end of this report

DBS Group Research . Equity

30 Aug 2017

BUY

Last Traded Price (29 Aug 2017): RM2.85 (KLCI : 1,761.14)
Price Target 12-mth: RM3.60 (26% upside) (Prev RM3.60)

Analyst

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What's New

- 2Q17 results above expectations, lifted by higher concession earnings and variation orders
- Balance sheet and operating cash flow improved
- Raising earnings for FY17-18F
- Maintain BUY and TP of RM3.60

Price Relative



Forecasts and Valuation

FY Dec (RM m)	2016A	2017F	2018F	2019F
Revenue	1,919	1,718	1,713	1,905
EBITDA	270	270	301	324
Pre-tax Profit	183	178	207	229
Net Profit	106	129	143	155
Net Pft (Pre Ex.)	106	129	143	155
Net Pft Gth (Pre-ex) (%)	22.7	21.8	11.6	8.3
EPS (sen)	21.9	26.7	29.7	32.2
EPS Pre Ex. (sen)	21.9	26.7	29.7	32.2
EPS Gth Pre Ex (%)	23	22	12	8
Diluted EPS (sen)	21.9	26.7	29.7	32.2
Net DPS (sen)	4.98	5.33	5.95	6.45
BV Per Share (sen)	203	224	249	275
PE (X)	13.0	10.7	9.6	8.8
PE Pre Ex. (X)	13.0	10.7	9.6	8.8
P/Cash Flow (X)	8.6	19.4	11.3	18.8
EV/EBITDA (X)	8.8	8.9	7.9	7.5
Net Div Yield (%)	1.7	1.9	2.1	2.3
P/Book Value (X)	1.4	1.3	1.1	1.0
Net Debt/Equity (X)	0.4	0.4	0.3	0.3
ROAE (%)	11.7	12.5	12.6	12.3
Earnings Rev (%):		9	9	
Consensus EPS (sen):		24.2	25.8	28.3
Other Broker Recs:		B: 5	S: 0	H: 1

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

All round 11MP Proxy

Scarcity premium. Muhibbah is an ideal proxy to the 11th Malaysia 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 licence offers an advantage. Other contractors do not have this combination to vie in the competitive civil engineering space.

Where we differ. Our TP is at the higher end of consensus as we believe the market has not fully appreciated its unique business model with varied construction expertise and strong recurring income. We estimate its 21% stake in the Cambodia airport concession to be worth conservatively RM677m (DCF, WACC 10% and average passenger traffic growth of 5% p.a. until 2040), which is already about half of the stock's market capitalisation. Revenues are also in USD which can help boost its earnings given the weak ringgit. Our EPS for FY18F and FY19F are above consensus as we have removed the potential dilution from an earlier proposed placement.

Potential catalysts. The sizeable recognition of lumpy variation orders (VO) has started to be recognised in 2Q17. Infrastructure wins for 2017 have been encouraging with YTD wins of RM0.8bn, comprising infrastructure-related works in Qatar and a marine-based contract for Bintulu Port. Total construction orderbook now stands at RM1.4bn while its total outstanding orderbook including cranes and shipyard is RM1.9bn (as at end-August). We expect Muhibbah to be present in projects from all parts of the construction value chain while a pick-up in oil and gas activities could see a resurgence in offshore cranes for Favelle Favco.

Valuation:

Muhibbah is a BUY with a SOP-derived TP of RM3.60. We value the stock based on SOP as we think this better reflects its diversified business while also capturing its cash-generating Cambodian concession.

Key Risks to Our View:

Delays in project flows and sudden spikes in raw material costs could dampen its earnings outlook.

Issued Capital (m shrs)	480
Mkt. Cap (RMm/US\$m)	1,369 / 321
Major Shareholders (%)	
Mac Ngan Boon	22.1
Lembaga Tabung Haji	9.6
Free Float (%)	60.7
3m Avg. Daily Val (US\$m)	0.54

ICB Industry : Industrials / Construction & Materials

WHAT'S NEW

Higher concession earnings and VO

2Q17 above expectations: This was due to lumpy VO and higher associate earnings.

Strong balance sheet: Net gearing and operating cash flow improved in the quarter.

BUY, TP unchanged at RM3.60 Muhibbah remains a cheap all round proxy to 11MP projects.

Above expectations. 2Q17 recorded a headline net profit of RM38m (+41% y-o-y, +29% q-o-q), bringing 1H17 net profit to RM67m (+33% y-o-y). This was above our and consensus estimates. There was a lumpy variation order recognition from one of its legacy projects which lifted its 2Q17 numbers while its concession profit was also very strong.

Group pretax profit higher y-o-y. For 1H17, its group pretax rose by 26% to RM112m. In terms of the segmental breakdown, construction contributed RM39m, cranes RM39m, concessions RM61m and there was group elimination of RM26m. With a RM1.4bn infrastructure orderbook (as at August 2017), this should ensure decent earnings visibility for more than a year. Total outstanding orderbook for its cranes division has been falling sequentially and now stands at RM536m (as at August 2017).

Higher associate earnings. 1H17 associate earnings jumped 2.3x to RM76m. The strong growth stemmed from robust traffic volume growth for its Cambodian airport concessions. 1H17 traffic volume grew by 23% to 4.2m passengers. Phnom Penh and Siem Reap showed passenger growth of 20% and 21% to 2.0m and 2.1m, respectively, while Silhanoukville passengers grew by 221% to 143k (coming from a low base).

Operating cash flow and balance sheet improved. As at 30 June 2016, Muhibbah's operating cash flow was RM215m and balance sheet was in a net debt of RM322m (net gearing of 0.2x). This compared to the previous quarter where net operating cash flow was negative RM116m and net debt of RM745m (net gearing of 0.5x). This was due to the cash received arising from the variation order for its legacy project in the Middle East.

Raising earnings. We lift our FY17-18F earnings each by 89 per annum to factor in the higher-than-expected concession earnings.

Quarterly / Interim Income Statement (RMm)

FY Dec	2Q2016	1Q2017	2Q2017	% chg yoy	% chg qoq
Revenue	406	241	468	15.1	93.7
Cost of Goods Sold	0.0	0.0	0.0	N/A	N/A
Gross Profit	406	241	468	15.1	93.7
Other Oper. (Exp)/Inc	(372)	(219)	(442)	19.0	102.0
Operating Profit	34.5	22.5	25.4	(26.4)	13.0
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	nm	nm
Associates & JV Inc	14.1	33.3	42.3	199.2	27.0
Net Interest (Exp)/Inc	(5.6)	(6.9)	(4.2)	26.2	40.1
Exceptional Gain/(Loss)	0.0	0.0	0.0	nm	nm
Pre-tax Profit	43.1	48.9	63.6	47.6	30.1
Tax	(8.2)	(4.5)	(9.8)	20.2	118.3
Minority Interest	(8.1)	(15.1)	(15.9)	(97.0)	5.7
Net Profit	26.8	29.3	37.8	41.1	29.1
Net profit bef Except.	26.8	29.3	37.8	41.1	29.1
EBITDA	48.7	55.8	67.7	39.1	21.3
Margins (%)					
Opg Profit Margins	8.5	9.3	5.4		
Net Profit Margins	6.6	12.1	8.1		

Source of all data: Company, AllianceDBS

CRITICAL DATA POINTS TO WATCH

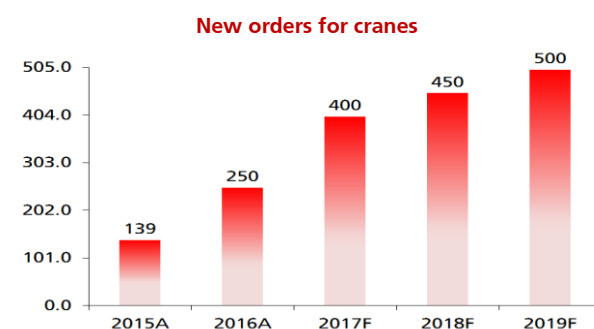
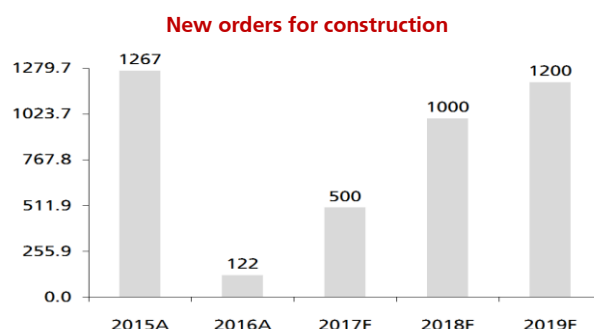
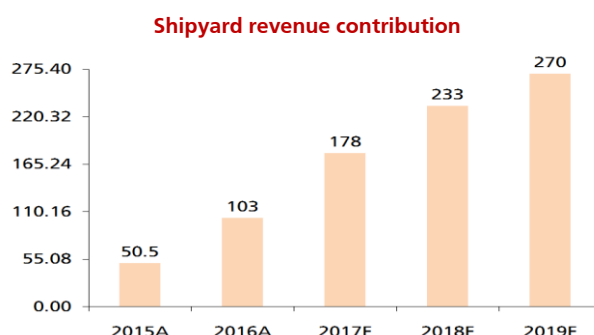
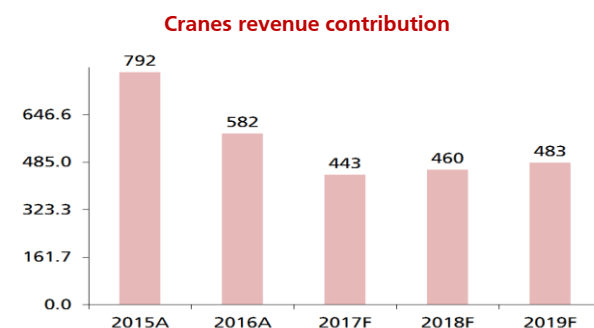
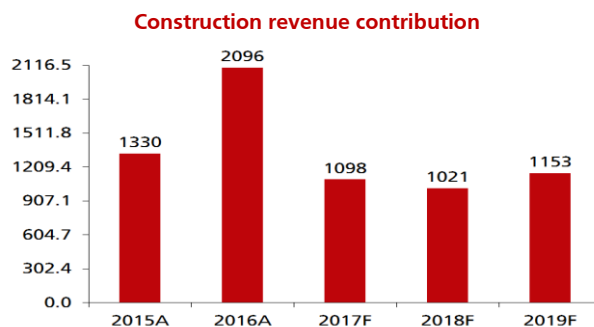
Critical Factors

Still a well-rounded 11MP proxy. Muhibbah’s construction franchise differs from the other bread and butter contractors given its varied expertise in the whole spectrum of the infrastructure chain. With its Petronas licence and marine-based expertise, Muhibbah is poised to clinch more ports and potentially RAPID contracts. Within our construction universe, Muhibbah stands out as an excellent proxy to the 11MP projects. Overall orderbook stood at RM1.9bn (as at August 2017). We believe this will grow further on the back of its strong execution track record while also anchored by its ability to replenish its orderbook.

Infrastructure division most promising. The infrastructure sector is on a multi-year upcycle with potential jobs from MRT Line 3, HSR, ECRL, RAPID and other port projects. Muhibbah will be bidding for major projects such as RAPID, MRT Line 3, LRT 3 and WCE, and is quietly confident of clinching other marine-based projects. 2016 order wins have been slow relative to 2015 with just two job wins, one from Petronas Carigali and the other for the Phnom Penh airport expansion. For 2017, it has started the year strongly with a sizeable wins for a project in Qatar and also Bintulu Port.

Cambodia airports to double capacity. Effective July 2016, the Siam Reap and Phnom Penh airports will double their existing capacity to 12m passengers. The US\$85m capex has been financed by only one year of operating cashflow, which suggests the airports are cash cows. Passenger arrivals reached 7.0m in 2016 (+9 % y-o-y), led by the recovery in Chinese tourists. Phnom Penh and Siem Reap airports showed passenger growth of 10% and 6% to 3.4m and 3.5m, respectively, while Silhanoukville passengers grew by 66% to 157k (coming from a low base). We estimate its 21% stake is worth RM677m (DCF, WACC 10%, RM/USD 4.15, and average passenger growth of 5% p.a. until 2040).

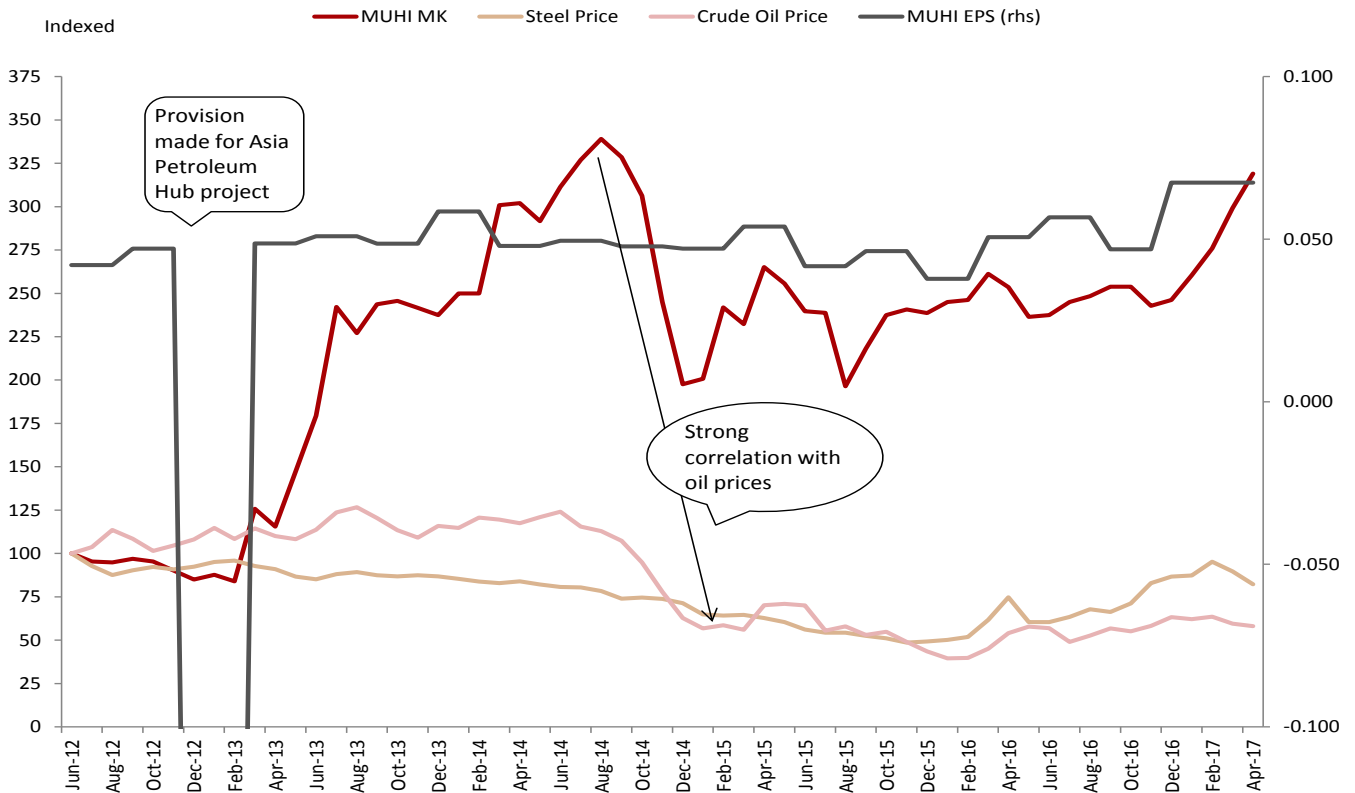
Favco capitalising on other revenue streams. Total outstanding orderbook now stands at RM536m (as at August 2017) which is sufficient for earnings visibility until 2017. Out of this amount, c.60% comes from offshore cranes (vs a peak of 95%). It is quite commendable that it has managed to reduce its dependency on offshore cranes by increasing the exposure to tower cranes. Locally, Favelle Favco has won a total of RM64m new orders so far this year largely for tower cranes. Note that Favelle Favco's cranes have been used to build 12 out of the 14 tallest buildings in the world. We understand there may be M&A opportunities given its strong balance sheet.



Source: Company, AllianceDBS

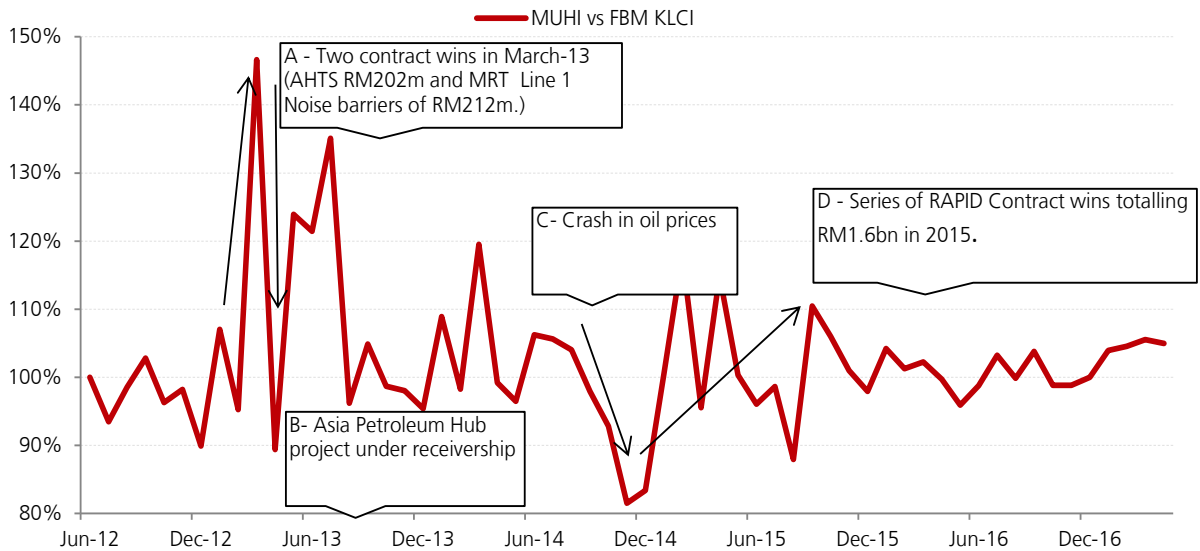
Appendix 1: A look at Company's listed history – what drives its share price?

Muhibbah's share price performance vs KLCI, Crude Oil price and EPS



Source: Company, AllianceDBS, DBSVI

Muhibbah's share price performance vs Key Newsflow (Contract Wins)



Source: Company, AllianceDBS, DBSVI

Muhibbah's key critical factors are crude oil prices, contract wins and negative earnings delivery. For Period A, Muhibbah's share price showed strong outperformance driven by high-margin AHTS wins and also MRT Line 1 noise barrier contract.

Subsequently for period B, the huge de-rating was a result of the Asia Petroleum Hub project being placed under receivership. Muhibbah was a contractor for this project and made a huge provision in its 4Q13 financials.

Muhibbah does not exhibit any long-term correlation with crude oil prices but for the period C where there was a big fall in oil prices (July 14-March 15), the correlation coefficient was 0.95x. This is because at that time up to 90% of its crane business came from the offshore segment.

The stock showed meaningful re-rating for the whole of 2015, driven by strong contract wins, including RM1.6bn from RAPID. In 2016, contract wins for infrastructure were disappointing, which resulted in a lacklustre share price performance.

Muhibbah Engineering

Balance Sheet:

Needs bigger balance sheet. Muhibbah’s shareholder’s funds as at 30 June 2017 stood at RM1.4bn (including minority interest). The proposed private placement of up to 10% of new shares has since lapsed. This may not be so crucial now given the expectations of a sizeable amount of variation order for one legacy project. We expect sizeable improvement in its cashflow and profitability from 2Q17 onwards.

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 it to clinch works from RAPID, MRT Line 2, LRT 3, highway and port projects.

Premium for recurring base. In our view, the market continues to discount the strong cashflow of its concession business, particularly the Cambodian airport concession. Contractors which have a higher degree of relatively assured income, such as IJM and Gamuda which own sizeable toll portfolios, should command premium valuations.

Capitalising on Petronas fabrication licence. Muhibbah was awarded the much sought-after Petronas licence to take on offshore facility construction and major onshore fabrication works. This suggests a higher chance of bagging more Petronas-related jobs (downstream works). It has a 57-acre fabrication yard with a total capacity of 25,000 MT per year, making it the third largest among Petronas-licensed fabricators.

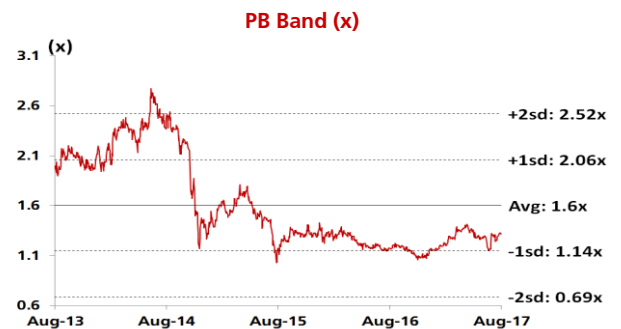
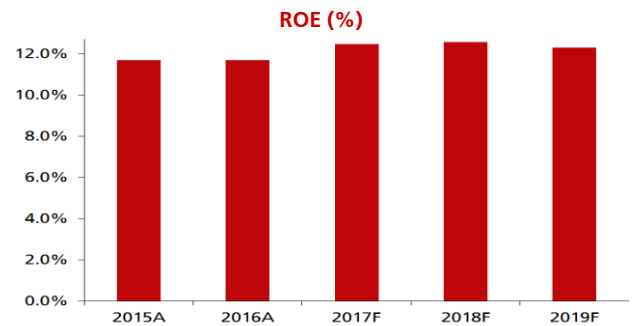
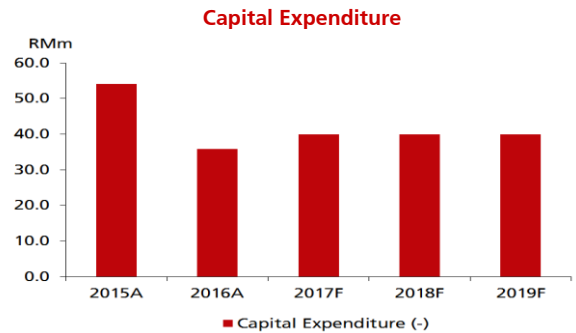
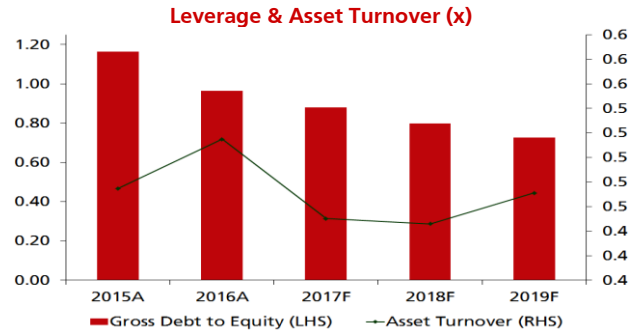
Completed landmark projects. Muhibbah has an impressive track record, having completed a list of landmark projects locally and abroad. Of significance is the LNG regasification project for Petronas Gas in Melaka and South Klang Valley Expressway.

Key Risks:

Delays in project flows and sudden spikes in raw material costs could dampen its earnings outlook.

Company Background

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



Source: Company, AllianceDBS

Key Assumptions

FY Dec	2015A	2016A	2017F	2018F	2019F
New orders for construction	1,267	122	500	1,000	1,200
New orders for cranes	139	250	400	450	500

Segmental Breakdown

FY Dec	2015A	2016A	2017F	2018F	2019F
Revenues (RMm)					
Construction	1,330	2,096	1,098	1,021	1,153
Cranes	792	582	443	460	483
Ships	50.5	103	178	233	270
Inter-segment	(568)	(862)	0.0	0.0	0.0
Total	1,605	1,919	1,718	1,713	1,905

Income Statement (RMm)

FY Dec	2015A	2016A	2017F	2018F	2019F
Revenue	1,605	1,919	1,718	1,713	1,905
Cost of Goods Sold	(1,343)	(1,669)	(1,460)	(1,431)	(1,600)
Gross Profit	262	250	258	283	305
Other Opng (Exp)/Inc	(138)	(138)	(145)	(146)	(152)
Operating Profit	124	112	113	137	153
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	62.2	88.2	92.6	97.2	102
Net Interest (Exp)/Inc	(20.7)	(18.0)	(27.2)	(26.7)	(26.2)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	165	183	178	207	229
Tax	(27.8)	(21.6)	(21.4)	(27.5)	(31.7)
Minority Interest	(51.3)	(55.5)	(28.2)	(36.3)	(41.9)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	86.0	106	129	143	155
Net Profit before Except.	86.0	106	129	143	155
EBITDA	251	270	270	301	324
Growth					
Revenue Gth (%)	(7.4)	19.6	(10.5)	(0.3)	11.2
EBITDA Gth (%)	10.1	7.5	0.2	11.3	7.7
Opg Profit Gth (%)	0.5	(9.1)	0.3	21.3	12.0
Net Profit Gth (Pre-ex) (%)	5.4	22.7	21.8	11.6	8.3
Margins & Ratio					
Gross Margins (%)	16.3	13.0	15.0	16.5	16.0
Opg Profit Margin (%)	7.7	5.9	6.6	8.0	8.0
Net Profit Margin (%)	5.4	5.5	7.5	8.4	8.2
ROAE (%)	11.7	11.7	12.5	12.6	12.3
ROA (%)	2.5	2.8	3.4	3.7	3.8
ROCE (%)	2.8	3.4	3.6	3.9	4.1
Div Payout Ratio (%)	27.9	22.8	20.0	20.0	20.0
Net Interest Cover (x)	6.0	6.2	4.1	5.1	5.8

Source: Company, AllianceDBS

Quarterly / Interim Income Statement (RMm)

FY Dec	2Q2016	3Q2016	4Q2016	1Q2017	2Q2017
Revenue	406	385	646	241	468
Cost of Goods Sold	0.0	0.0	0.0	0.0	0.0
Gross Profit	406	385	646	241	468
Other Oper. (Exp)/Inc	(372)	(363)	(614)	(219)	(442)
Operating Profit	34.5	21.7	31.6	22.5	25.4
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	14.1	12.2	20.8	33.3	42.3
Net Interest (Exp)/Inc	(5.6)	(6.6)	(3.6)	(6.9)	(4.2)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	43.1	27.3	48.7	48.9	63.6
Tax	(8.2)	5.29	0.16	(4.5)	(9.8)
Minority Interest	(8.1)	(10.0)	(16.5)	(15.1)	(15.9)
Net Profit	26.8	22.6	32.4	29.3	37.8
Net profit bef Except.	26.8	22.6	32.4	29.3	37.8
EBITDA	48.7	33.9	52.4	55.8	67.7

Growth

Revenue Gth (%)	(15.7)	(5.3)	67.7	(62.6)	93.7
EBITDA Gth (%)	33.4	(30.3)	54.4	6.6	21.3
Opg Profit Gth (%)	90.4	(37.1)	45.3	(28.7)	13.0
Net Profit Gth (Pre-ex) (%)	12.9	(15.9)	43.6	(9.5)	29.1

Margins

Opg Profit Margins (%)	8.5	5.6	4.9	9.3	5.4
Net Profit Margins (%)	6.6	5.9	5.0	12.1	8.1

Balance Sheet (RMm)

FY Dec	2015A	2016A	2017F	2018F	2019F
Net Fixed Assets	785	804	784	762	737
Invt in Associates & JVs	257	437	525	618	716
Other LT Assets	52.8	48.1	48.1	48.1	48.1
Cash & ST Invt	578	735	742	798	802
Inventory	301	268	240	255	285
Debtors	1,601	1,544	1,412	1,408	1,566
Other Current Assets	18.1	22.4	22.4	22.4	22.4
Total Assets	3,594	3,859	3,774	3,911	4,177
ST Debt	1,221	1,260	1,260	1,260	1,260
Creditor	1,136	1,058	840	823	921
Other Current Liab	33.6	19.0	19.0	19.0	19.0
LT Debt	48.9	73.1	73.1	73.1	73.1
Other LT Liabilities	64.2	66.8	66.8	66.8	66.8
Shareholder's Equity	826	978	1,082	1,200	1,326
Minority Interests	265	405	433	469	511
Total Cap. & Liab.	3,594	3,859	3,774	3,911	4,177
Non-Cash Wkg. Capital	751	757	815	843	934
Net Cash/(Debt)	(692)	(597)	(591)	(535)	(531)
Debtors Turn (avg days)	333.8	299.1	314.0	300.4	284.9
Creditors Turn (avg days)	300.2	250.3	248.3	222.6	207.7
Inventory Turn (avg days)	75.3	65.0	66.5	66.2	64.3
Asset Turnover (x)	0.5	0.5	0.5	0.4	0.5
Current Ratio (x)	1.0	1.1	1.1	1.2	1.2
Quick Ratio (x)	0.9	1.0	1.0	1.0	1.1
Net Debt/Equity (X)	0.6	0.4	0.4	0.3	0.3
Net Debt/Equity ex MI (X)	0.8	0.6	0.5	0.4	0.4
Capex to Debt (%)	4.3	2.7	3.0	3.0	3.0
Z-Score (X)	1.1	1.2	1.3	1.3	1.4

Source: Company, AllianceDBS

Cash Flow Statement (RMm)

FY Dec	2015A	2016A	2017F	2018F	2019F
Pre-Tax Profit	165	183	178	207	229
Dep. & Amort.	65.2	69.2	64.9	66.7	68.5
Tax Paid	(27.8)	(21.6)	(21.4)	(27.5)	(31.7)
Assoc. & JV Inc/(loss)	(62.2)	(88.2)	(92.6)	(97.2)	(102)
Chg in Wkg.Cap.	(174)	13.4	(58.3)	(27.9)	(90.4)
Other Operating CF	64.1	3.65	0.0	0.0	0.0
Net Operating CF	30.8	159	70.7	121	73.2
Capital Exp.(net)	(54.1)	(35.8)	(40.0)	(40.0)	(40.0)
Other Invt.(net)	0.0	0.0	0.0	0.0	0.0
Invt in Assoc. & JV	0.0	0.0	0.0	0.0	0.0
Div from Assoc & JV	0.0	0.0	0.0	0.0	0.0
Other Investing CF	60.7	13.1	0.0	0.0	0.0
Net Investing CF	6.56	(22.7)	(40.0)	(40.0)	(40.0)
Div Paid	(19.1)	(24.0)	(24.0)	(25.7)	(28.7)
Chg in Gross Debt	32.9	63.2	0.0	0.0	0.0
Capital Issues	19.6	5.76	0.0	0.0	0.0
Other Financing CF	(93.5)	(23.8)	0.0	0.0	0.0
Net Financing CF	(60.2)	21.2	(24.0)	(25.7)	(28.7)
Currency Adjustments	0.0	0.0	0.0	0.0	0.0
Chg in Cash	(22.8)	157	6.72	55.5	4.54
Opg CFPS (sen)	42.4	30.2	26.8	30.9	33.9
Free CFPS (sen)	(4.8)	25.5	6.37	16.8	6.89

Source: Company, AllianceDBS

Target Price & Ratings History



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

S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	01 Sep 16	2.24	3.10	BUY
2:	30 Nov 16	2.20	3.10	BUY
3:	11 Jan 17	2.39	3.10	BUY
4:	01 Mar 17	2.47	3.10	BUY
5:	27 Apr 17	2.88	3.10	BUY
6:	28 Apr 17	2.89	3.10	BUY
7:	02 May 17	2.95	3.38	BUY
8:	01 Jun 17	2.71	3.60	BUY

Source: AllianceDBS

Analyst: Chong Tjen-San

AllianceDBS recommendations are based on an Absolute Total Return* Rating system, defined as follows:

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 i.e. > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

Completed Date: 30 Aug 2017 09:20:16 (MYT)

Dissemination Date: 30 Aug 2017 09:22:19 (MYT)

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