

Company Guide

Muhibbah Engineering

Version 9 | Bloomberg: MUHI MK | Reuters: MUHI.KL

Refer to important disclosures at the end of this report

Malaysia Equity Research

1 Jun 2017

BUY

Last Traded Price (31 May 2017): RM2.75 (KLCI : 1,765.87)

Price Target 12-mth: RM3.60 (31% upside) (Prev RM3.38)

Potential Catalyst: Higher orders for construction and cranes, stronger passenger arrivals for airports

Where we differ: Our EPS for FY17F is in line with consensus but is higher for FY18F

Analyst

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What's New

- **In-line 1Q17 results; earnings lifted by concessions**
- **Expect strong 2Q17 from recognition of lumpy VO**
- **Eyeing a combination of marine and infrastructure projects**
- **BUY, with higher SOP-derived TP of RM3.60**

Price Relative



Forecasts and Valuation

FY Dec (RM m)	2015A	2016A	2017F	2018F
Revenue	1,605	1,919	1,718	1,713
EBITDA	251	270	259	289
Pre-tax Profit	165	183	167	196
Net Profit	86.0	106	117	132
Net Pft (Pre Ex.)	86.0	106	117	132
Net Pft Gth (Pre-ex) (%)	5.4	22.7	11.3	12.2
EPS (sen)	17.8	21.9	24.4	27.3
EPS Pre Ex. (sen)	17.8	21.9	24.4	27.3
EPS Gth Pre Ex (%)	5	23	11	12
Diluted EPS (sen)	17.8	21.9	24.4	27.3
Net DPS (sen)	4.98	4.98	4.87	5.47
BV Per Share (sen)	171	203	222	245
PE (X)	15.4	12.6	11.3	10.1
PE Pre Ex. (X)	15.4	12.6	11.3	10.1
P/Cash Flow (X)	43.1	8.3	18.7	10.9
EV/EBITDA (X)	9.1	8.6	9.1	8.1
Net Div Yield (%)	1.8	1.8	1.8	2.0
P/Book Value (X)	1.6	1.4	1.2	1.1
Net Debt/Equity (X)	0.6	0.4	0.4	0.3
ROAE (%)	11.7	11.7	11.5	11.7
Earnings Rev (%):		0	0	0
Consensus EPS (sen):		N/A	24.2	25.4
Other Broker Recs:		B: 4	S: 0	H: 2

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

Scarcity premium contractor

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.

Cash cow: Cambodia airport concession. Siam Reap and Phnom Penh airports have doubled their capacity to 12m passengers. Passenger arrivals grew 9% to 7.0m in FY16. We estimate its 21% stake in the Cambodia airport concession to be worth 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 MYR.

Sizeable wins for 2017. Contract flows for its infrastructure division in 2016 have been slow with just two smallish wins. Infrastructure wins for 2017 have been encouraging with a QAR356.7m (c.RM438m) win for infrastructure-related works in Qatar and a marine-based contract for Bintulu Port amounting to RM585m, where it has a 51% stake in the JV. Muhibbah's 51% stake would imply a contract value of RM298m but we understand the value of works could be higher. Assuming 70%, Muhibbah's share of works could amount to RM409m. Hence, we estimate YTD wins amount to RM847m. Total construction orderbook now stands at RM1.5bn while its total outstanding orderbook including cranes and shipyard is RM2.1bn. We also understand there could be sizeable recognition of lumpy variation orders (VO) from 2Q17 onwards from one legacy project.

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.

At A Glance

Issued Capital (m shrs)	480
Mkt. Cap (RMm/US\$m)	1,321 / 308
Major Shareholders (%)	
Mac Ngan Boon	22.1
Lembaga Tabung Haji	9.6
Free Float (%)	60.7
3m Avg. Daily Val (US\$m)	0.72

ICB Industry : Industrials / Construction & Materials



WHAT'S NEW

Boosted by concessions

In-line 1Q17 results: 1Q17 net profit grew 23% y-o-y.

Lumpy recognition of VO: Expect lumpy recognition of VO to boost profit from 2Q17 onwards.

BUY, raising TP to RM3.60: Our higher TP factors in the removal of its proposed private placement which has been deferred.

In-line performance. 1Q17 recorded a headline net profit of RM29m (+23% y-o-y, -10% q-o-q). This was in line with our and consensus estimates. There will be lumpy variation order recognition from one of its legacy projects which will be recognised from 2Q17 onwards.

Lower construction and crane earnings. For 1Q17, its construction division registered a pretax profit of RM24m, which is a 20% decline on a y-o-y basis. The lower profit is likely due to a combination of seasonal factors and timing of recognition of projects. Its RM1.5bn infrastructure orderbook (as at end-April 2017) should ensure decent earnings visibility for more than a year.

The crane business under Favelle Favco also showed a decline of 10% y-o-y in 1Q17 pretax profit to RM17m. Total outstanding orderbook now stands at RM620m (as at end-April 2017) which is sufficient for earnings visibility until 2017. Out of this amount, c.63% comes from offshore cranes (vs peak of 95%). We understand there has also been higher demand for the rental of cranes from its European customers.

Higher associate earnings. 1Q17 associate earnings jumped 65% y-o-y to RM32m. The strong growth is likely from higher earnings from Roadcare arising from the concession renewal while traffic volume growth for its Cambodian airport concessions was also buoyant. 1Q17 traffic volume grew by 18% y-o-y to 2.36m passengers. Phnom Penh and Siem Reap airports showed passenger growth of 17% and 14% y-o-y to 1.0m and 1.26m, respectively, while Silhanoukville's passengers grew by 199% y-o-y to 30k – coming from a low base.

Raising our TP. We raise our TP to RM3.60 (vs RM3.38) by removing the potential dilution of its private placement, in light of the fact that the time frame to complete the exercise has already lapsed.

Quarterly / Interim Income Statement (RMm)

FY Dec	1Q2016	4Q2016	1Q2017	% chg yoy	% chg qoq
Revenue	482	646	241	(49.9)	(62.6)
Other Oper. (Exp)/Inc	(464)	(614)	(219)	(52.8)	(64.3)
Operating Profit	18.1	31.6	22.5	23.9	(28.7)
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	nm	nm
Associates & JV Inc	18.3	20.8	33.3	81.7	60.1
Net Interest (Exp)/Inc	(2.5)	(3.6)	(6.9)	(180.3)	(90.5)
Exceptional Gain/(Loss)	0.0	0.0	0.0	nm	nm
Pre-tax Profit	34.0	48.7	48.9	43.7	0.3
Tax	(8.1)	0.16	(4.5)	(44.6)	(2,877.8)
Minority Interest	(2.1)	(16.5)	(15.1)	(603.7)	(8.7)
Net Profit	23.8	32.4	29.3	23.4	(9.5)
Net profit bef Except.	23.8	32.4	29.3	23.4	(9.5)
EBITDA	36.5	52.4	55.8	53.0	6.6
Margins (%)					
Opg Profit Margins	3.8	4.9	9.3		
Net Profit Margins	4.9	5.0	12.1		

Source of all data: Company, AllianceDBS

CRITICAL DATA POINTS TO WATCH

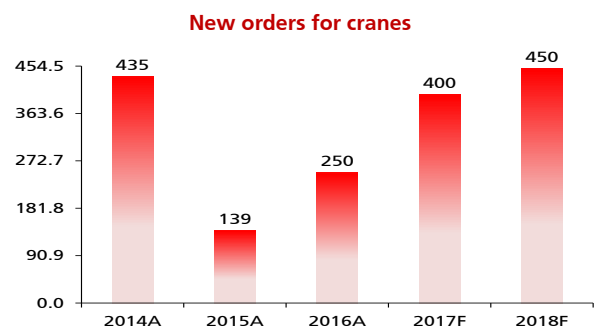
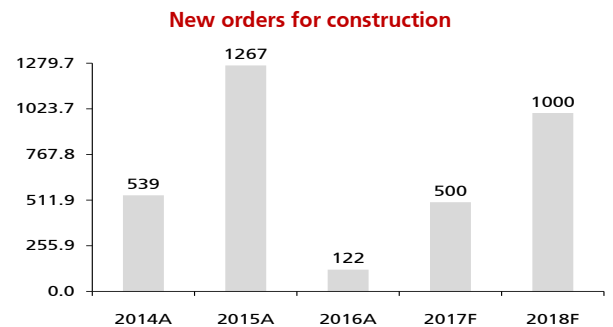
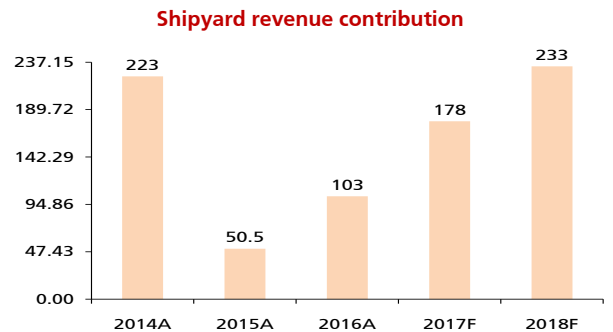
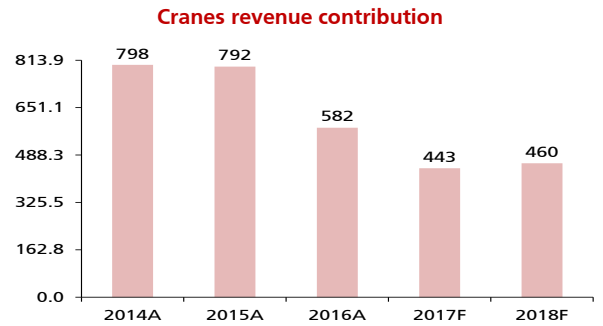
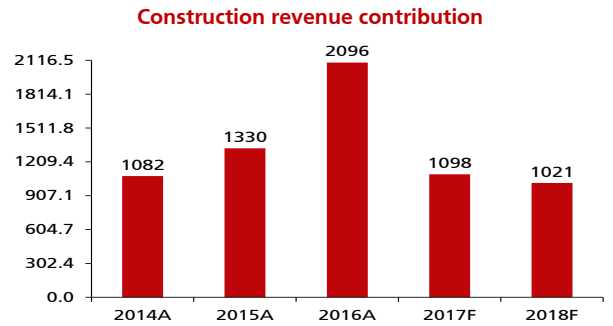
Earnings Drivers:

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 RM2.1bn (as at April 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 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 RM620m (as at April 2017) which is sufficient for earnings visibility until 2017. Out of this amount, c.63% 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

Muhibbah Engineering

Balance Sheet:

Needs bigger balance sheet. Muhibbah's shareholder's funds as at 31 March 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.

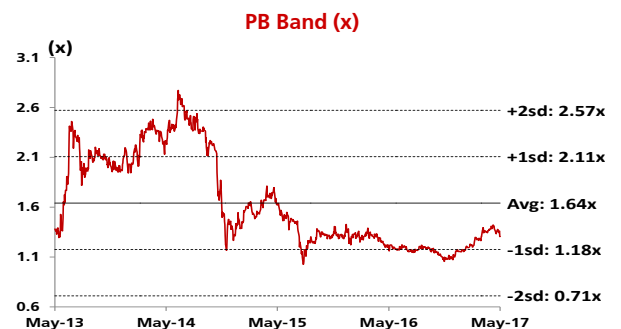
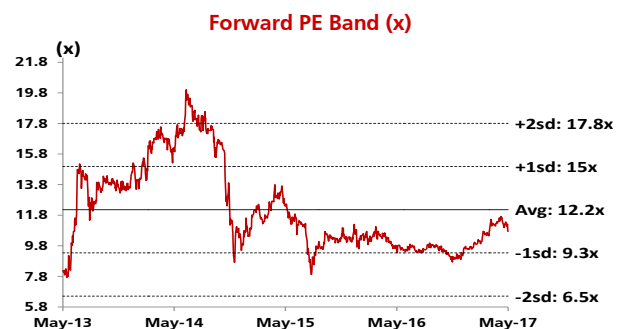
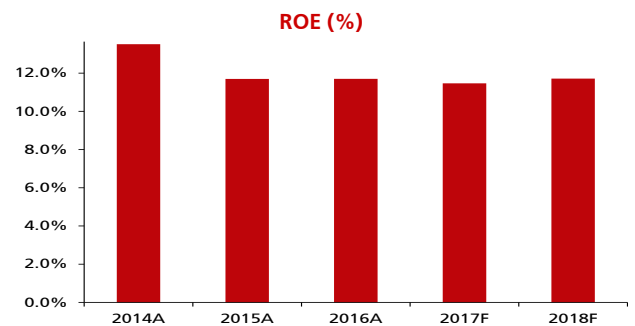
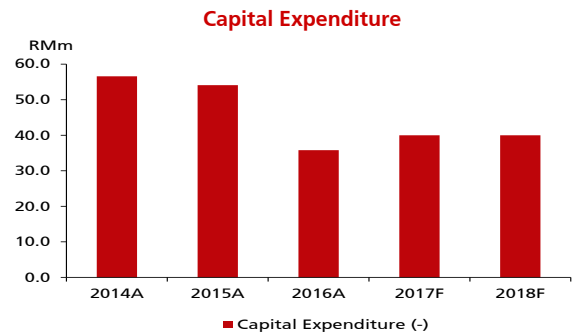
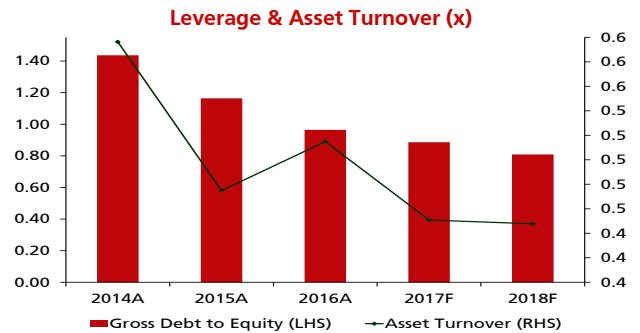
Completed landmark projects. Muhibbah has an impressive track record, having completed a list of landmark projects locally and abroad. Of significance is the LNG regasification project for Petronas Gas in Melaka and South Klang Valley Expressway.

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	2014A	2015A	2016A	2017F	2018F
Construction revenue	1,082	1,330	2,096	1,098	1,021
Cranes revenue contribution	798	792	582	443	460
Shipyards revenue contribution	223	50.5	103	178	233
New orders for construction	539	1,267	122	500	1,000
New orders for cranes	435	139	250	400	450

Segmental Breakdown

FY Dec	2014A	2015A	2016A	2017F	2018F
Revenues (RMm)					
Construction	1,082	1,330	2,096	1,098	1,021
Cranes	798	792	582	443	460
Ships	223	50.5	103	178	233
Inter-segment	(369)	(568)	(862)	0.0	0.0
Total	1,734	1,605	1,919	1,718	1,713

Income Statement (RMm)

FY Dec	2014A	2015A	2016A	2017F	2018F
Revenue	1,734	1,605	1,919	1,718	1,713
Cost of Goods Sold	(1,479)	(1,343)	(1,669)	(1,460)	(1,431)
Gross Profit	254	262	250	258	283
Other Opng (Exp)/Inc	(131)	(138)	(138)	(145)	(146)
Operating Profit	123	124	112	113	137
Other Non Opng (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	49.2	62.2	88.2	81.6	85.7
Net Interest (Exp)/Inc	(28.5)	(20.7)	(18.0)	(27.2)	(26.7)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	144	165	183	167	196
Tax	(24.8)	(27.8)	(21.6)	(21.4)	(27.5)
Minority Interest	(37.3)	(51.3)	(55.5)	(28.2)	(36.3)
Preference Dividend	0.0	0.0	0.0	0.0	0.0
Net Profit	81.6	86.0	106	117	132
Net Profit before Except.	81.6	86.0	106	117	132
EBITDA	228	251	270	259	289
Growth					
Revenue Gth (%)	(10.5)	(7.4)	19.6	(10.5)	(0.3)
EBITDA Gth (%)	10.9	10.1	7.5	(3.9)	11.5
Opg Profit Gth (%)	17.2	0.5	(9.1)	0.3	21.3
Net Profit Gth (Pre-ex) (%)	(5.6)	5.4	22.7	11.3	12.2
Margins & Ratio					
Gross Margins (%)	14.7	16.3	13.0	15.0	16.5
Opg Profit Margin (%)	7.1	7.7	5.9	6.6	8.0
Net Profit Margin (%)	4.7	5.4	5.5	6.8	7.7
ROAE (%)	13.5	11.7	11.7	11.5	11.7
ROA (%)	2.8	2.5	2.8	3.1	3.4
ROCE (%)	2.8	2.8	3.4	3.2	3.5
Div Payout Ratio (%)	23.4	27.9	22.8	20.0	20.0
Net Interest Cover (x)	4.3	6.0	6.2	4.1	5.1

Source: Company, AllianceDBS

Muhibbah Engineering

Quarterly / Interim Income Statement (RMm)

FY Dec	1Q2016	2Q2016	3Q2016	4Q2016	1Q2017
Revenue	482	406	385	646	241
Other Oper. (Exp)/Inc	(464)	(372)	(363)	(614)	(219)
Operating Profit	18.1	34.5	21.7	31.6	22.5
Other Non Opg (Exp)/Inc	0.0	0.0	0.0	0.0	0.0
Associates & JV Inc	18.3	14.1	12.2	20.8	33.3
Net Interest (Exp)/Inc	(2.5)	(5.6)	(6.6)	(3.6)	(6.9)
Exceptional Gain/(Loss)	0.0	0.0	0.0	0.0	0.0
Pre-tax Profit	34.0	43.1	27.3	48.7	48.9
Tax	(8.1)	(8.2)	5.29	0.16	(4.5)
Minority Interest	(2.1)	(8.1)	(10.0)	(16.5)	(15.1)
Net Profit	23.8	26.8	22.6	32.4	29.3
Net profit bef Except.	23.8	26.8	22.6	32.4	29.3
EBITDA	36.5	48.7	33.9	52.4	55.8

Growth

Revenue Gth (%)	11.6	(15.7)	(5.3)	67.7	(62.6)
EBITDA Gth (%)	(42.0)	33.4	(30.3)	54.4	6.6
Opg Profit Gth (%)	(37.5)	90.4	(37.1)	45.3	(28.7)
Net Profit Gth (Pre-ex) (%)	18.3	12.9	(15.9)	43.6	(9.5)

Margins

Opg Profit Margins (%)	3.8	8.5	5.6	4.9	9.3
Net Profit Margins (%)	4.9	6.6	5.9	5.0	12.1

Balance Sheet (RMm)

FY Dec	2014A	2015A	2016A	2017F	2018F
Net Fixed Assets	725	785	804	784	762
Invts in Associates & JVs	236	257	437	514	595
Other LT Assets	31.0	52.8	48.1	48.1	48.1
Cash & ST Invts	601	578	735	742	800
Inventory	226	301	268	240	255
Debtors	1,334	1,601	1,544	1,412	1,408
Other Current Assets	12.5	18.1	22.4	22.4	22.4
Total Assets	3,165	3,594	3,859	3,763	3,890
ST Debt	1,168	1,221	1,260	1,260	1,260
Creditor	966	1,136	1,058	840	823
Other Current Liab	38.8	33.6	19.0	19.0	19.0
LT Debt	69.3	48.9	73.1	73.1	73.1
Other LT Liabilities	61.9	64.2	66.8	66.8	66.8
Shareholder's Equity	644	826	978	1,071	1,179
Minority Interests	217	265	405	433	469
Total Cap. & Liab.	3,165	3,594	3,859	3,763	3,890
Non-Cash Wkg. Capital	567	751	757	815	843
Net Cash/(Debt)	(636)	(692)	(597)	(591)	(533)
Debtors Turn (avg days)	253.7	333.8	299.1	314.0	300.4
Creditors Turn (avg days)	245.4	300.2	250.3	248.3	222.6
Inventory Turn (avg days)	55.5	75.3	65.0	66.5	66.2
Asset Turnover (x)	0.6	0.5	0.5	0.5	0.4
Current Ratio (x)	1.0	1.0	1.1	1.1	1.2
Quick Ratio (x)	0.9	0.9	1.0	1.0	1.1
Net Debt/Equity (X)	0.7	0.6	0.4	0.4	0.3
Net Debt/Equity ex MI (X)	1.0	0.8	0.6	0.6	0.5
Capex to Debt (%)	4.6	4.3	2.7	3.0	3.0
Z-Score (X)	1.2	1.1	1.2	1.3	1.4

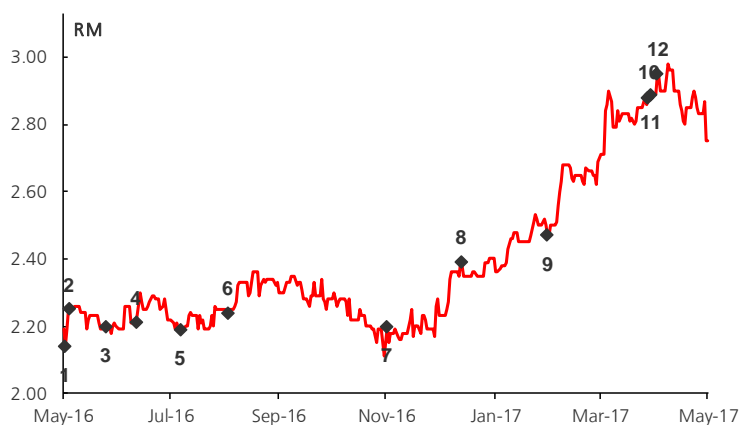
Source: Company, AllianceDBS

Cash Flow Statement (RMm)

FY Dec	2014A	2015A	2016A	2017F	2018F
Pre-Tax Profit	144	165	183	167	196
Dep. & Amort.	55.8	65.2	69.2	64.9	66.7
Tax Paid	(24.8)	(27.8)	(21.6)	(21.4)	(27.5)
Assoc. & JV Inc/(loss)	(49.2)	(62.2)	(88.2)	(81.6)	(85.7)
Chg in Wkg.Cap.	(258)	(174)	13.4	(58.3)	(27.9)
Other Operating CF	59.9	64.1	3.65	0.0	0.0
Net Operating CF	(72.9)	30.8	159	70.7	121
Capital Exp.(net)	(56.6)	(54.1)	(35.8)	(40.0)	(40.0)
Other Invt.(net)	0.0	0.0	0.0	0.0	0.0
Invt in Assoc. & JV	(45.6)	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	66.6	60.7	13.1	0.0	0.0
Net Investing CF	(35.6)	6.56	(22.7)	(40.0)	(40.0)
Div Paid	(18.9)	(19.1)	(24.0)	(24.0)	(23.5)
Chg in Gross Debt	362	32.9	63.2	0.0	0.0
Capital Issues	(13.7)	19.6	5.76	0.0	0.0
Other Financing CF	(46.4)	(93.5)	(23.8)	0.0	0.0
Net Financing CF	283	(60.2)	21.2	(24.0)	(23.5)
Currency Adjustments	0.0	0.0	0.0	0.0	0.0
Chg in Cash	175	(22.8)	157	6.72	57.7
Opg CFPS (sen)	38.4	42.4	30.2	26.8	30.9
Free CFPS (sen)	(26.8)	(4.8)	25.5	6.37	16.8

Source: Company, AllianceDBS

Target Price & Ratings History



S.No.	Date of Report	Closing Price	12-mth Target Price	Rating
1:	01 Jun 16	2.14	3.10	BUY
2:	03 Jun 16	2.25	3.10	BUY
3:	24 Jun 16	2.20	3.10	BUY
4:	11 Jul 16	2.21	3.10	BUY
5:	05 Aug 16	2.19	3.10	BUY
6:	01 Sep 16	2.24	3.10	BUY
7:	30 Nov 16	2.20	3.10	BUY
8:	11 Jan 17	2.39	3.10	BUY
9:	01 Mar 17	2.47	3.10	BUY
10:	27 Apr 17	2.88	3.10	BUY
11:	28 Apr 17	2.89	3.10	BUY
12:	02 May 17	2.95	3.38	BUY

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

Source: AllianceDBS

Analyst: Chong Tjen-San

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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