COMPANY UPDATE

MISC (MISC MK)

More Potential Trading Upside On Contract Wins (LNG)

While surging tanker rates may have largely priced in current market expectations, we believe contract wins could be the next leg of trading upside, akin to the 2019 case. Petronas may have to decide soon on its 14 LNG newbuilds amid limited yard space. This is not well-guided from MISC's angle, as it is still subject to speculation and competition. After evaluating market conditions, we raised our valuation for more potential contract wins. Maintain HOLD, with adjusted target price of RM8.00.

WHAT'S NEW

- **Petronas may have to decide soon on LNG newbuilds.** Several articles from industry shipping source Tradewinds highlighted the massive rush of LNG producers to secure the limited yard space for new LNG ship deliveries. Petronas itself had been evaluating for the past year for up to 14 of its LNG newbuilds between three Korean yards and a Chinese yard. MISC is among the shortlisted nine shipowners. The dilemma for Petronas is only increasing, as they require these newbuilds for fleet replacement, but berths are running out for 2025/26 deliveries. At the same time, LNG newbuild costs surged to an all-time high (>US$220m, vs US$185m yoy) owing to cost inflation. Charter rates and tenures are not revealed. Please see table on next page for further details.
- **Petronas LNG newbuilding potential is not explicitly guided by management** or major newsflows, except for Tradewinds. We believe this cautiousness may be due to: a) uncertainties in capex and IRR, as costs have surged, and b) competition remains tight given the decision for Petronas to evaluate nine shipowners for 14 vessels. Both Petronas and MISC had signalled strong intentions to diversify the business for LNG. MISC had been securing new contracts via non-Petronas charterers since 2019. Petronas had also demonstrated the same by not prioritising MISC for LNG newbuilds. In 2021, the LNG producer inked a long-term charter with Hyundai LNG for three newbuild 174,000 cbm vessels, which are earmarked for 2Q24 delivery and to be used for LNG Canada's cargo exports. Petronas has chartered a fleet of 27 LNG vessels worldwide.
- **Contract win potential may be the next leg for trading upside.** While surging tanker rates may be largely priced in (as per our previous note highlighting a trading upside to RM7.75), we now believe the high tanker rate is sustainable, moreover the share price may have yet to factor market's speculation for the next contract wins. Historically, MISC had traded at >RM8.00 in 2019, when the group's bidding appetite was revealed to be as high as US$4b for FPSO Mero-3 (Brazil) and LNG ships. Ahead of its 1Q22 results on 26 May 22, management appeared to be less optimistic on guiding such new bidding appetite. But in our view, the US$3m global bond programme (US$1m issued so far) is an indirect but strong indication of future opportunities across LNG, FPSO and petroleum.

KEY FINANCIALS

Year to 31 Dec (RMm)	2020	2021	2022F	2023F	2024F
Net turnover	9,401	10,672	9,013	9,228	9,513
EBITDA	4,108	3,898	4,070	4,300	4,474
Operating profit	2,017	1,948	1,957	1,999	1,986
Net profit (rep./act.)	(43)	2,259	1,708	1,733	1,846
Net profit (adj.)	1,802	1,889	1,708	1,733	1,846
EPS (sen)	40.4	42.3	38.3	38.8	41.4
PE (x)	19.3	18.4	20.4	20.1	18.9
P/B (x)	1.1	1.0	1.0	1.0	1.0
EV/EBITDA (x)	11.6	12.2	11.7	11.0	10.6
Dividend yield (%)	4.2	4.2	3.8	3.8	3.8
Net margin (%)	(0.5)	21.2	18.9	18.8	19.4
Net debt/(cash) to equity (%)	20.4	26.6	34.6	20.4	30.8
Interest cover (x)	11.2	9.3	8.0	9.3	10.1
ROE (%)	n.a.	6.8	5.0	5.0	5.2
Consensus net profit	-	-	1,980	2,084	2,169
UOBKH/Consensus (x)	-	-	0.86	0.83	0.85

Source: MISC Berhad, Bloomberg, UOB Kay Hian

**Note: Our forecasts exclude finance lease construction gains, which may differ from consensus estimates*

HOLD

(Maintained)

Share Price	RM7.80
Target Price	RM8.00
Upside	+2.6%
(Previous TP	*RM7.15)*

COMPANY DESCRIPTION

Shipping company.

STOCK DATA

GICS sector	Industrials
Bloomberg ticker:	MISC MK
Shares issued (m):	4,463.7
Market cap (RMm):	34,817.2
Market cap (US$m):	8,050.2
3-mth avg daily t'over (US$m):	4.3

Price Performance (%)

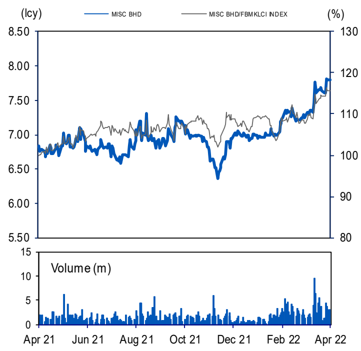
52-week high/low RM7.81/RM6.36

1mth	3mth	6mth	1yr	YTD
7.6	11.4	8.3	14.5	10.6

Major Shareholders	%
Petroliam Nasional Bhd	51.1
Employees Provident Fund	12.4

FY22 NAV/Share (RM)	7.74
FY22 Net Debt/Share (RM)	2.68

PRICE CHART



Source: Bloomberg

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ESSENTIALS

- **Traditionally, LNG ships support trades for long-term gas offtake agreements**, although those contracts are entirely separate vs the charter agreements. As per our O&G sector report in Apr 22, the rush for energy security may give producers some leverage to negotiate for higher long-term LNG prices, unlike the past few years whereby buyers were demanding flexibility. The last long-term offtake prices by Qatar was done at 10% slope (ie proportion) to Brent prices in 2021, and Beijing Gas at <13% to Brent in Jan 22. Under oil price parity, oil-linked LNG prices are usually locked in coefficients of 10-17% to Brent. If future long-term LNG prices are locked in at >17% to Brent, it may imply the return of US$20/MMBtu in pre-2014 periods (vs the low of US$4-5/MMBtu). Potentially, the corresponding LNG charter agreements can afford higher rates/IRR.
- **MISC will need the fleet replacement** for as many as 13 LNG vessels (out of 30), whereby the long term charters will expire in 2023-27. Out of these, about 10 vessels are of 130,000 cbm capacity and running on steam turbines, which means they are obsolete and the likelihood of recharter is low. Although we have no details on the exact dates, if we assume the ship expiries are timed closely with the offtake expiries in Bintulu terminals and Petronas' portfolio contracts (as per O&G sector report), the expiries may be spread at 3/5/2/3 for 2024-27 respectively. This means up to eight will need to be ordered now for 2025 deliveries, to ensure no net fleet reduction. Our rough back-of-envelope calculations suggest a LNG ship (US$200m capex) with a 15-year charter and 9% IRR offers DCF upside of RM0.15/share, although the real IRR/capex is still uncertain at this point.
- **Raised new contract win potential to RM1.10/share from RM0.50/share.** Our previous assumption (excluding FPSO Mero-3, under its own separate segment) is now too conservative, given that MISC should be benefiting on tightening LNG and FPSO markets, while green shipping is increasingly crucial. Our new assumption is a base case of four LNG newbuildings (>US$200m) under long-term charters, and more contract potential from FPSO and petroleum (AET) division. MISC is competing with Yinson and Bumi Armada on FPSO bids like Cameia (Angola). Similarly, AET is expected to secure contracts like the long-term shuttle tankers, in order to meet its 2025 target of long-term EBITDA mix of 73%. MISC is evaluating other LNG producers' offers and other gas vessel types.

EARNINGS REVISION/RISK

- **Increased 2022F earnings by 10%, leaving other forecasts unchanged.** Although industry tanker rates may still gradually recover, we now view that MISC's predominantly Aframax-heavy fleet will enjoy a more decent recovery for 2022 and assume profit position for petroleum (vs small loss in previous 2022F forecast). We account that the tankers will continue to benefit from the upcoming 1m bpd US strategic petroleum reserve release effective May 22, which may be attractive to Asian refineries due to the price differentials to Brent. We also account recent tanker M&A trends like Frontline-EuroNav M&A (combined global fleet of 67 VLCC), which will hasten the industry's consolidation and improve breakevens.

VALUATION/RECOMMENDATION

- **Maintain HOLD, new target price of RM8.00 (from RM7.15),** implying 21x 2022F PE (at +1SD of five-year average PE band). We raised petroleum valuation from RM1.64 following higher P/B to 1.1x (as we now expect tanker to be at profit position), and higher contract wins. These are partly offset by higher net debt as we factor in more bond proceeds, and an unchanged 15% discount on Gumusut due to litigation uncertainties (this may be a risk for the global bonds, if utilised to refinance the loans). The recent share price re-rating had largely factored in positive tanker sentiment. Having said, the strong tanker rates for MISC's routes may appear sustainable, and like the 2019 case, we now see further trading upside to factor in potential new contracts. A bull case trading target price may be at RM8.90, which assumes MISC securing >50% of Petronas' LNG newbuilding demand (>7 vessels).

ENVIRONMENTAL, SOCIAL, GOVERNANCE (ESG) UPDATES

- **Environmental**
  - **Carbon (CO2) reduction.** Adding new vessels with LNG-dual/ammonia fuel to meet net-zero emission by 2050 (50% reduction of greenhouse gas by 2030).
  - **Promoting circular economy via green ship recycling.** Aims to avoid wastage while disposing aged vessels that do not meet carbon reduction criteria.
- **Social**
  - **Diversity.** >20 nationalities; >40% female proportion amongst onshore staff.
  - **Safety (HSE).** Lost Time Injury Frequency (LTIF) remains low at 0.15 (2020: 0.04).
- **Governance**
  - **Achieved 5/5 rating (FTSE4Good)** for governance & supply chain management.

SNAPSHOT OF LNG NEWBUILD DEMAND/SUPPLY

4 yards for Petronas's 14 LNG newbuilds. Petronas is considering 11 berths at South Korea's big 3 yards (3-4 slots at Daewoo, 4 slots at Hyundai Heavy and 2-3 at Samsung Heavy); and 2-3 berths at China's Hudong-Zhonghua Shipbuilding.
9 shipowners for Petronas' LNG newbuilds. Aside from MISC, other names shortlisted are SK Shipping, H-Line, Mitsui OSK Lines, NYK Line, K Line, BW LNG, Knutsen LNG and TMS Cardiff Gas. Each owner is able to work with >3 shipyards on their bids.
Limited yard capacity for LNG newbuilds. The Korean yards can only build up to 60 ships p.a. – with Hyundai yards up to 25 p.a., Daewoo yards up to 20 p.a., and Samsung Heavy up to 15 p.a.. Hudong-Zhonghua Shipbuilding, which until recently was the only Chinese builder of large LNG carriers, is particularly full for orders reserved for Qatar. 2 more China yards from Jiangnan and Dalian are new to the LNG space, and will need time to build up expertise.
Capex costs for LNG newbuilds rising. Aside from China which may offer discounts, it now costs >$220m per new LNG ship, vs US$185m just a year ago. This may not include retrofit options like air lubrication technology, which may cost another US$7m.
Competition for yard space increasingly tight. >30 berths were secured in 1Q22 alone, with the lion's share going to Korea and China taking on 8 orders. Qatar alone has reserved massive yard slots of up to 151 since 2020 for 2024-26 delivery.
2Q22 is set to be busy, The latest orders were pegged at US$237m each for 3 ships for Venture Global (US) for 2025 deliveries. BW LNG also made orders for 2 ships. QatarEnergy has up to 30 orders to decide in 2022, and Petronas is expected to decide soon.

Source: Tradewinds

SEGMENT FORECASTS

(RMm)	2022F	2023F	2024F
Revenue	9,013.3	9,228.5	9,512.8
LNG	2,788.8	2,567.7	2,463.0
Petroleum	3,570.3	4,069.3	4,333.4
MMHE	1,501.0	1,490.0	1,670.0
Offshore	1,153.3	1,101.4	1,046.5
EBIT	1,957.2	1,999.4	1,985.5
LNG	1,422.3	1,232.5	1,182.2
Petroleum	125.7	255.0	336.4
MMHE	(144.3)	(16.8)	(35.4)
Offshore	553.6	528.7	502.3

Source: UOB Kay Hian.

SOTP BREAKDOWN (AT RM4.1/US$)

Segments	Valuation	RM/share
LNG	DCF, 6.5% WACC	3.58
Petroleum	1.1x P/B (from 0.8x)	2.23
MMHE (66.5%)	Based on RM0.42 TP	0.09
Gumusut	0.85x P/B	1.25
Kikeh (51%)	1x P/B	0.19
FPSO Mero 3	DCF, assume 50% stake	0.40
Other offshore	0.9x P/B	0.23
(-) Net debt	LNG (RM5b); others (RM4b, up from <RM2b)	(1.07)
(+) New contracts	Higher potential contracts from FPSO, LNG or DPST	1.10
SOTP	21x 2022F PE, 4% yield	8.00

Source: Bloomberg, UOB Kay Hian.

PROFIT & LOSS

Year to 31 Dec (RMm)	2021	2022F	2023F	2024F
Net turnover	10,672	9,013	9,228	9,513
EBITDA	3,898	4,070	4,300	4,474
Deprec. & amort.	1,949	2,113	2,301	2,489
EBIT	1,948	1,957	1,999	1,986
Total other non-operating income	370	n.a.	n.a.	n.a.
Associate contributions	301	286	272	379
Net interest income/(expense)	(417)	(506)	(462)	(444)
Pre-tax profit	2,202	1,737	1,809	1,920
Tax	(41)	(78)	(81)	(86)
Minorities	98	48	6	12
Net profit	2,259	1,708	1,733	1,846
Net profit (adj.)	1,889	1,708	1,733	1,846

BALANCE SHEET

Year to 31 Dec (RMm)	2021	2022F	2023F	2024F
Fixed assets	23,386	25,565	27,744	29,923
Other LT assets	21,294	21,197	14,455	16,485
Cash/ST investment	7,952	7,248	6,286	5,978
Other current assets	4,889	4,361	4,458	4,593
Total assets	57,521	58,372	52,943	56,979
ST debt	8,309	9,905	7,000	2,905
Other current liabilities	4,118	2,472	2,464	2,519
LT debt	8,720	9,301	6,396	13,977
Other LT liabilities	1,449	1,449	1,449	1,449
Shareholders' equity	34,163	34,531	34,926	35,432
Minority interest	762	714	708	696
Total liabilities & equity	57,521	58,372	52,943	56,979

CASH FLOW

Year to 31 Dec (RMm)	2021	2022F	2023F	2024F
Operating	2,909	3,992	4,219	4,388
Pre-tax profit	2,202	1,737	1,809	1,920
Tax	(989)	(78)	(81)	(86)
Other operating cashflows	1,695	2,332	2,491	2,554
Investing	(3,135)	(3,718)	(718)	(3,718)
Capex (growth)	(3,775)	(4,358)	(4,358)	(4,358)
Others	640	640	3,640	640
Financing	1,499	(979)	(4,465)	(979)
Others/interest paid	1,499	(979)	(4,465)	(979)
Net cash inflow (outflow)	1,272	(705)	(964)	(309)
Beginning cash & cash equivalent	6,855	7,952	7,248	6,286
Changes due to forex impact	(175)	1	1	1
Ending cash & cash equivalent	7,952	7,248	6,286	5,978

KEY METRICS

Year to 31 Dec (%)	2021	2022F	2023F	2024F
Profitability				
EBITDA margin	36.5	45.2	46.6	47.0
Pre-tax margin	20.6	19.3	19.6	20.2
Net margin	21.2	18.9	18.8	19.4
ROA	4.1	2.9	3.1	3.4
ROE	6.8	5.0	5.0	5.2
Growth				
Turnover	13.5	(15.5)	2.4	3.1
EBITDA	(5.1)	4.4	5.7	4.1
Pre-tax profit	n.a.	(21.1)	4.1	6.1
Net profit	n.a.	(24.4)	1.5	6.5
Net profit (adj.)	4.8	(9.6)	1.5	6.5
EPS	4.8	(9.6)	1.5	6.5
Leverage				
Debt to total capital	32.8	35.3	27.3	31.8
Debt to equity	49.8	55.6	38.4	47.6
Net debt/(cash) to equity	26.6	34.6	20.4	30.8
Interest cover (x)	9.3	8.0	9.3	10.1

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