

3Q18 results announced on 22 Nov 2018 were below expectations

23 November 2018

Construction & Engineering | Construction

Malaysian Resources Corp

Looking Past Near-Term Earnings Weakness; BUY

Buy (Maintained)

Target Price:	MYR1.08
Price:	MYR0.73
Market Cap:	USD765m
Bloomberg Ticker:	MRC MK

Maintain BUY with a revised TP of MYR1.08 from MYR1.20, 48% upside plus 3% FY19F yield. Despite reporting 9M18 core earnings that grew 28% YoY, earnings missed our and consensus estimates. During the earnings call, management updated analysts that contractual terms for its turnkey role for the LRT3 project are being sorted out. This will be followed by negotiations with WPCs with normal pace of works to resume in Jan-Feb 2019. On the bright side, it is fairly confident of maintaining 5-6% margins as the turnkey contractor. After concluding its MYR1.3bn settlement agreement with the Government for the EDL, MRCB foresees the 80% disposal of Bukit Jalil Sentral for MYR1.14bn to draw closer to completion in Dec 2018 – bringing net gearing down to 0.22x. Despite expectations of bumpy near-term earnings, we continue to rate MRCB a BUY premised on its significant de-gearing exercise, large MYR11bn outstanding construction orderbook and the long-term potential of its TODs.

Booked a MYR28m gain on disposal. Malaysian Resources Corp (MRCB) reported 3Q18 earnings that declined 24% YoY to MYR21.2m. For the third quarter, MRCB's property division registered a PBT of MYR34m (flat YoY) as it booked a pre-tax gain on disposal of MYR37.6m for the sale of a parcel of land located along Jalan Kia Peng. The construction division fared less favourably, with PBT declining 88% YoY to MYR4m as it booked unprofitable preliminary works for its property division, eg Cyberjaya City Centre. This largely negated higher JV contributions from the Light Rail Transit 3 (LRT3) project of MYR20.7m (more than doubled YoY). All said, 9M18 core earnings grew 28% YoY to MYR79m, missing our and consensus estimates at 65-73% of FY18 forecasts.

More clarity on LRT3. During the earnings call, MRCB informed analysts that it expects to execute the letter of award (LOA) by mid-Dec 2018 for its appointment as the turnkey contractor for the LRT3 project at a fixed cost of MYR11.9bn. Thereafter, it will commence negotiations with work package contractors (WPCs) followed by the issuance of termination and reappointment letters, provided terms are agreeable. This is expected to last about a month or two, before works on LRT3 resume at a normal pace in Jan-Feb 2019 (only basic, low valued works are carried out presently). As such, MRCB is guiding for minimal contributions from LRT3 for 4Q18. On the bright side, it is fairly confident of maintaining margins as the turnkey contractor at 5-6%. Including the LRT3 turnkey project, MRCB's total outstanding orderbook amounts to MYR11bn.

Huge potential for its TODs in the long run. Compensation for the termination of Eastern Dispersal Link (EDL) is scheduled to arrive in 1Q19, with a MYR24m one-off gain likely to be booked. Next, MRCB's disposal of an 80% stake of its Bukit Jalil Sentral development to the Employees Provident Fund (EPF) for MYR1.14bn could complete by Dec 2018, bringing net gearing down further to approximately 0.22x. We think MRCB's much improved balance sheet would allow it, along with its partners, to develop prized transit-oriented developments (TODs) in Kwasa Damansara, Bukit Jalil Sentral, KL Sentral, Cyberjaya City Centre and Penang Sentral with combined GDV of MYR42bn over the next 20 years, hence our positive long-term view on the stock. In the meantime, MRCB has MYR1.6bn of unbilled sales, having generated MYR356m worth of new sales YTD. It is likely to lower its 2018 target to MYR520m from MYR700m, management added.

Maintain BUY. We expect near-term earnings to be choppy, as it sorts out contractual terms for the LRT3 project and softer contributions from its property division as projects are in the preliminary stages where billings are slower, and so we cut our FY18-20 earnings forecasts by 13-14%. Our TP is trimmed to MYR1.08 as we reduce our target P/E multiple for the construction division to 12x (similar to our large-cap construction universe) and increase our discount to RNAV to 25% (from 20%) – to reflect a continued slowdown in the property market. Our BUY recommendation, however, remains unchanged premised on MRCB's significant de-gearing exercise, large MYR11bn outstanding construction orderbook and the long-term potential of its TODs.

Forecasts and Valuations	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total turnover (MYRm)	2,408.1	2,823.7	2,168.2	2,035.2	2,071.8
Reported net profit (MYRm)	267.4	167.6	104.7	138.4	140.9
Recurring net profit (MYRm)	264.6	167.6	104.7	138.4	140.9
Recurring net profit growth (%)	(17.9)	(37.3)	(37.5)	32.2	1.8
Recurring EPS (MYR)	0.12	0.07	0.02	0.03	0.03
DPS (MYR)	0.03	0.02	0.02	0.02	0.03
Recurring P/E (x)	5.85	11.13	30.65	23.18	22.77
P/B (x)	0.53	0.39	0.65	0.65	0.64
P/CF (x)	11.04	(1.23)	2.01	11.61	14.73
Dividend Yield (%)	3.8	2.4	2.7	3.0	3.4
EV/EBITDA (x)	9.14	13.60	16.89	15.62	15.36
Return on average equity (%)	10.3	4.3	2.1	2.8	2.8
Net debt to equity (%)	28.57	25.80	12.81	12.47	10.23
Our vs consensus EPS (adjusted) (%)			(4%)	(3%)	

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Source: Company data, RHB

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Figure 1: MRCB's results review

FYE Dec (MYRm)	3QFY17	2QFY18	3QFY18	QoQ (%)	YoY (%)	9MFY17	9MFY18	YoY (%)	Comments
Revenue	1,134.1	405.2	663.8	63.8	(41.5)	2,415.5	1,496.6	(38.0)	Declines in construction and property divisions
EBIT	85.2	54.0	42.3	(21.6)	(50.3)	215.5	120.5	(44.1)	
<i>EBIT Margin (%)</i>	7.5	13.3	6.4			8.9	8.1		
Interest expense	(41.4)	(16.8)	(15.1)	(10.0)	(63.6)	(114.0)	(36.1)	(68.3)	
Associates	(0.2)	5.8	13.2	nm	nm	14.2	29.7	n.m.	
Pretax profit	52.3	43.0	40.5	(5.9)	nm	115.8	114.1	(1.5)	Helped by land sales of MYR31.3m in 2Q18 and MYR37.6m in 3Q18
<i>Pretax Margin (%)</i>	4.6	10.6	6.1			4.8	7.6		
Tax	(21.8)	(10.8)	(22.0)	104.8	1.0	(38.8)	(37.7)	(2.7)	
<i>Effective tax rate (%)</i>	41.7	25.0	54.4			33.5	33.1		
Net Profit	28.1	32.3	18.4	(42.8)	(34.3)	61.9	76.3	23.3	
Core Profit	28.1	32.3	21.2	(34.2)	(24.4)	61.9	79.1	27.8	Below expectations
<i>Net Margin (%)</i>	2.5	8.0	3.2			2.6	5.3		

Source: Company data, RHB

Figure 2: MRCB's SOP valuation

Items	FV (MYRm)	BV (MYR m)	Equity value/surplus (MYRm)
Construction (12x 1-year forward earnings)			341.5
Property and investments			1,109.2
31% MQ REIT	357.6	264.0	93.6
Kwasa Damansara PDP for infra works			77.4
Shareholders Funds (excl. construction)			4,762.09
Proceeds from Warrants B @ MYR1.25			548.15
Total RNAV			6,931.84
Share base			4,803.97
RNAV per share			1.44
Discount			25%
Target Price (MYR)			1.08

Source: Company data, RHB

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