Delays in negotiations

MRCB reported disappointing 1H18 results due to slow property sales and progress billings and losses at its infrastructure division. Net profit rose 68% yoy to RM55m in 1H18, boosted by a RM24m one-off gain after tax from the disposal of land in Penang. Core net profit grew 14% yoy to RM31.2m, mainly driven by its construction division. We cut our core FY18-20E EPS by 53-57% to reflect lower property earnings and infrastructure division losses. We maintain our BUY call with a reduced TP of RM0.88, based on a 40% discount to RNAV.

Below expectations

MRCB's net profit of RM55m (+68% yoy) in 1H18 comprised only 25-33% of the consensus and our previous full-year forecasts of RM165-217m. Core net profit grew 14% yoy to RM31m. MRCB saw slow property sales due to the weak market sentiment and some of its new construction projects were still at the early stages. Revenue declined 33% yoy to RM838.8m as all divisions posted lower revenue: construction (-45% yoy); property (-8% yoy); infrastructure (-97% yoy); building services (-12% yoy).

Construction earnings surge

Construction operating profit surged 168% yoy to RM41m in 1H18 as progress billings accelerated for its projects such as LRT Line 3 (share of joint venture profit of RM15m), MRT Line 2 and several commercial buildings. The remaining order book of RM5.1bn, equivalent to 2.9x its construction FY17 revenue, will likely sustain its activities.

Potential new contracts

MRCB-George Kent Joint Venture is negotiating to take over the LRT Line 3 project as the main contractor and reduce the cost from RM9-10bn from RM15-16bn, giving up its role as the Project Delivery Partner. Execution risk is higher as any cost overrun is borne by the main contractor.

Maintain BUY

The potential sale of Eastern Dispersal Link (EDL) by end-2018 and taking over the LRT Line 3 project as a main contractor are potential catalysts for an upward re-rating of the stock. As a result of our EPS forecast revisions, we cut our RNAV/share estimate to RM1.46 from RM1.56. Based on the same 40% discount to RNAV, we cut our TP to RM0.88 from RM0.94. Nonetheless, we maintain our BUY call on the compelling Price/RNAV of 0.5x. Key risks: slower property sales and construction execution risks.

Earnings & Valuation Summary

FYE 31 Dec	2016	2017	2018E	2019E	2020E
Revenue (RMm)	2,408.1	2,823.7	2,106.6	1,872.3	1,824.5
EBITDA (RMm)	288.1	261.4	260.2	248.6	271.4
Pretax profit (RMm)	392.6	247.3	228.2	196.9	247.6
Net profit (RMm)	267.4	167.6	160.8	138.4	175.2
EPS (sen)	13.8	6.6	3.7	3.2	4.0
PER (x)	5.1	10.7	19.1	22.2	17.5
Core net profit (RMm)	22.0	117.2	101.5	138.4	174.2
Core EPS (sen)	0.6	4.6	2.3	3.2	4.0
Core EPS growth (%)	56.8	282.6	(37.7)	20.8	16.7
Core PER (x)	107.8	15.3	30.3	22.2	17.6
Net DPS (sen)	2.8	1.8	1.8	1.8	1.8
Dividend Yield (%)	3.9	2.5	2.5	2.5	2.5
EV/EBITDA (x)	19.4	16.2	15.5	14.5	15.1
Chg in core EPS (%)			(53.3)	(57.2)	(56.5)
Affin/Consensus (x)			1.0	0.7	0.7

Source: Company, Affin Hwang forecasts, Bloomberg

Results Note

MRCB

MRC MK
Sector: Construction & Infrastructure

RM0.70 @ 30 August 2018

BUY (maintain)

Upside 26%

Price Target: RM0.88

Previous Target: RM0.94

	1M	3M	12M
Absolute	-10.8%	22.8%	-33.2%
Rel to KLCI	-13.2%	16.0%	-34.9%

Stock Data

Issued shares (m)	4,390.8
Mkt cap (RMm)/(US$m)	3073.5/747.9
Avg daily vol - 6mth (m)	25.9
52-wk range (RM)	0.55-1.31
Est free float	36.9%
BV per share (RM)	1.10
P/BV (x)	0.63
Net cash/ (debt) (RMm) (2Q18)	(3,436.4)
ROE (2018E)	3.3%
Derivatives	Yes
Warr 2027 (RM0.255, EP: RM1.25)	
Shariah Compliant	Yes

Key Shareholders

EPF	35.5%
Gapurna Sdn Bhd	16.6%
Lembaga Tabung Haji	7.0%

Source: Affin Hwang, Bloomberg

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Property sales lagging target

Property earnings fell 29% yoy to RM55m in 1H18 as its Easton Burwood project in Melbourne was completed in 2017 and its new projects are still at early implementation stages. Low pre-sales of RM261m in 1H18 indicate that its FY18 sales target of RM1bn is unlikely to be achieved; Pre-sales of RM0.7bn this year are more likely. High unbilled sales of RM1.67bn, equivalent to 1.9x its FY17 property revenue, will likely sustain its activities. However, we expect a lower property EBIT (-22% yoy) in FY18 on a profit margin squeeze despite higher revenue.

De-gearing efforts continue

MRCB is pursuing the potential injection of its land in Bukit Jalil for the KL Sports City project into a 20%-owned joint venture with EPF (RM1.34bn asset value). MRCB will be appointed as the property manager for the project, lifting its order book by about RM11bn and earning fees over the development period.

It is also negotiating with the government to buy back or pay compensation for the termination of its Eastern Dispersal Link (EDL) concession (RM1.135bn asset value). A favourable outcome could lead to an exceptional gain and provide the cash to reduce MRCB's current net gearing of 0.69x to 0.26x. MRCB had completed the disposal of the German Embassy land to PERKESO for RM323m on 3 July 2018; the estimated disposal gain of RM28m will boost its earnings in 3Q18.

The change in government and leadership at EPF have led to delays in the completion of both deals. However, we gather that good progress has been made on the negotiations and both deals are expected to be completed by end-2018.

Fig 1: Results comparison

FYE 31 Dec (RMm)	2Q17	1Q18	2Q18	QoQ % chg	YoY % chg	1H17	1H18	YoY % chg	2Q18 Comment
Revenue	**725.3**	**427.6**	**405.2**	***(5.2)***	***(44.1)***	**1,245.1**	**832.8**	***(33.1)***	1H18: Lower revenue for all divisions: construction (-45%), property (-8%), infrastructure (-97%) and building services (-12%).
Op costs	(655.4)	(412.9)	(353.5)	*(14.4)*	*(46.1)*	(1,113.5)	(766.4)	*(31.2)*	Lower operating costs due to cost-saving initiatives and value engineering.
EBITDA	69.9	14.7	51.8	*251.5*	*(25.9)*	131.6	66.5	*(49.5)*	
EBITDA margin (%)	*9.6*	*3.4*	*12.8*	*9.3ppt*	*3.1ppt*	*10.6*	*8.0*	*(2.6ppt)*	
Depreciation	(19.8)	(6.5)	(8.8)	*36.7*	*(55.3)*	(35.3)	(15.3)	*(56.7)*	
EBIT	**50.1**	**8.3**	**42.9**	***419.4***	***(14.3)***	**96.2**	**51.2**	***(46.8)***	
Int expense	(37.4)	(4.3)	(16.8)	*292.2*	*(55.2)*	(72.6)	(21.0)	*(71.0)*	
Int and other inc	11.3	15.9	(20.2)	*(227.3)*	*(279.8)*	26.9	(4.3)	*(116.1)*	
Associates	6.8	10.7	5.8	*(45.8)*	*n.m*	5.7	16.5	*190.7*	Higher contribution from LRT3 JV project.
Exceptional items	3.8	0.0	31.3	*#DIV/0!*	*723.7*	5.4	31.3	*479.6*	Land sale gain in 2Q18.
Pretax profit	**34.6**	**30.6**	**43.0**	***40.8***	***24.4***	**61.6**	**73.6**	***19.5***	
Core pretax profit	**30.8**	**30.6**	**11.7**	***(61.6)***	***(61.9)***	**56.2**	**42.3**	***(24.7)***	Higher operating profit for construction division partially offset by lower profits for other divisions.
Tax	(7.9)	(4.9)	(10.8)	*118.2*	*36.7*	(16.3)	(15.7)	*(3.7)*	
Tax rate (%)	*28.3*	*24.8*	*28.9*	*4.1ppt*	*0.6ppt*	*26.5*	*21.3*	*(5.1ppt)*	
Minority interests	(2.7)	(4.1)	1.2	*(128.8)*	*(144.1)*	(12.6)	(2.9)	*(76.9)*	
Net profit	**24.0**	**21.5**	**33.4**	***55.4***	*39.1*	**32.7**	**55.0**	***68.4***	Below expectations.
EPS (sen)	1.1	0.5	0.8	*55.1*	*(29.0)*	1.5	1.3	*(17.2)*	
Core net profit	**21.2**	**21.5**	**9.7**	***(55.1)***	***(54.3)***	**27.3**	**31.2**	***14.4***	Exclude one-off gains.

Source: Affin Hwang estimates, Company

Fig 2: Segmental operating profit

FYE 31 Dec (RMm)	2Q17	1Q18	2Q18	QoQ % chg	YoY % chg	1H17	1H18	YoY % chg
Engineering & construction	14.0	16.0	25.0	*56.1*	*78.0*	15.3	41.0	*168.1*
Property devt & invt	30.1	24.1	30.9	*28.0*	*2.8*	77.9	55.1	*(29.4)*
Infrastructure	11.5	(1.3)	(1.7)	*30.2*	*(114.7)*	29.0	(3.0)	*NA*
Building services	7.1	0.2	0.7	*316.4*	*(90.3)*	10.8	0.9	*(92.1)*
Investment holding & others	5.1	(11.6)	2.8	*NA*	*(44.1)*	0.5	(8.7)	*NA*
Total	**67.8**	**27.4**	**57.7**	**110.4**	**(14.9)**	**133.6**	**85.1**	***(36.3)***

Source: Affin Hwang estimates, Company

Fig 3: Segmental operating profit margin

FYE 31 Dec (%)	2Q17	1Q18	2Q18	QoQ ppt	YoY ppt	1H17	1H18	YoY ppt
Engineering & construction	3.0	8.4	13.0	*4.6*	*10.0*	2.2	10.7	*8.5*
Property devt & invt	14.5	11.0	16.0	*5.0*	*1.5*	17.3	13.3	*(4.0)*
Infrastructure	40.4	NA	NA	*NA*	*NA*	50.8	NA	*NA*
Building services	55.7	1.3	5.3	*4.0*	*(50.4)*	36.6	3.3	*(33.3)*
Total	**9.4**	**6.4**	**14.2**	***7.8***	***4.8***	**10.7**	**10.2**	***(0.5)***

Source: Affin Hwang estimates, Company

Fig 4: Potential de-gearing exercises and impact

RM million	1H FY2018	Post: EPF's subscription in Bkt Jalil Sentral	Post: EDL Compensation	Post: Disposal of Ascott	Post: Disposal of Celcom
Bank Borrowings	2,871	1,733	1,733	1,733	1,733
EDL Financing	1,023	1,023	-	-	-
Total Borrowings	3,894	2,756	1,733	1,733	1,733
Cash & Bank Balances	(455)	(455)	(455)	(585)	(649)
Net Borrowings/(Cash)	3,439	2,301	1,278	1,148	1,084
Total Equity	**4,960**	**4,960**	**4,960**	**4,960**	**4,960**
Net Gearing (times)	**0.69**	**0.46**	**0.26**	**0.23**	**0.22**

Source: Company

Fig 5: Change in RNAV and target price assumptions

Segment	New value (RMm)	Old value (RMm)	Change (%)
Property development	4,869	4,997	(3)
Property investment	1,557	1,557	0
Construction	1,021	1,192	(14)
Concession	18	335	(95)
Car Park & REIT	530	530	0
Total	**7,996**	**8,611**	**(7)**
Net cash/(debt)	(1,599)	(1,599)	0
RNAV	**6,397**	**7,012**	**(9)**
No. of shares	4,385	4,385	0
RNAV / share	**1.46**	**1.60**	**(9)**
Fully-diluted no. of shares	4,385	4,385	0
Fully-diluted RNAV	**1.46**	**1.60**	**(9)**
Target price @ 40% discount	0.88	1.28	(32)

Source: Affin Hwang estimates

Equity Rating Structure and Definitions

BUY	Total return is expected to exceed +10% over a 12-month period
HOLD	Total return is expected to be between -5% and +10% over a 12-month period
SELL	Total return is expected to be below -5% over a 12-month period
NOT RATED	Affin Hwang Investment Bank Berhad does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation

The total expected return is defined as the percentage upside/downside to our target price plus the net dividend yield over the next 12 months.

OVERWEIGHT	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
NEUTRAL	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
UNDERWEIGHT	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

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