Muhibbah Engineering (M)

Is it Right to Call for a Rights Now?

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MARKET PERFORM ↓

Cum-Price/Ex-Price :	**RM0.62/RM0.58**
Target Price/Ex-TP :	**RM0.60/0.565 ↓**

We were negatively surprised by Muhibah's proposed rights issue to raise RM120m and using most of the proceeds to pare down debt; a poor allocation of capital in our view. This untimely rights announcement could also insinuate potential cash collection issues in the immediate term. While we raise FY22E earnings by 6% to account for interest savings, call is downgraded to MP (from OP) with lower SoP-TP of RM0.60 (previously RM1.25).

Proposed rights issue to potentially raise RM120m. Muhibah has proposed a 1:2 rights issue to potentially raise c.RM120m if all 242m rights are fully subscribed at the tentative price of RM0.50. Proceeds raised would be used to pare down debts (RM96.7m i.e. 80% of proceeds) while the rest will be used for working capital (RM23.3m i.e. 19%) and defray the expenses required for this exercise (RM0.9m i.e. 1%). Post exercise by 2QCY22, Muhibah's net gearing is expected to fall to 0.35x (currently 0.50x) and there will be interest savings of RM3.0m from the reduced debt.

Unexpected rights issue. We were completely caught off guard by such an exercise to pare down debts as Muhibah's: (i) net gearing has been trending down from its peak of 0.58x in 4QFY19 and currently stands at manageable levels of 0.50x, (ii) receivable turnover days have remained rather healthy by historical means at 292 days (vs. 5-year average of 279 days), and (iii) operating cash-flows remains positive.

Furthermore, its declining outstanding order-book in its infrastructure division (currently standing at RM300m) should technically translate to more cash upon project completion since no cash outlay is required for new project deployment. Also, the retention sums (typically 5% of contract value) to be received post-project completion should also mean healthier cash levels moving forward.

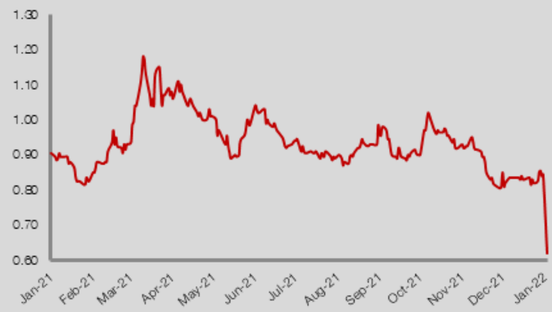
Poor use of proceeds. In a low interest rate environment, we opined that the use of equity to solely pare down debts to save on 3% interest costs is a poor allocation of capital which dilutes EPS and ROE. **What's more perplexing** was that our checks with management revealed that they are comfortable with a net gearing of below 2.0x (currently only 0.5x) and there is currently no covenant that prohibits them from raising additional borrowings.

Potential cash-flows issues lurking? With so much additional debt head room (it can raise another RM1.65b before hitting the 2.0x net gearing limit), we opined that such rights exercise potentially alludes to: (i) the inability to collect receivables which could lead to cash constraints and impairments, and (ii) inability to raise additional debt to bridge funding needs.

While an acquisition could potentially be on the cards, we still feel using debt to fund such acquisitions would be a better option. Even if equity was the preferred choice for funding, it would be wiser to time the rights announcement alongside the acquisition which would clear suspicion over cash-flows issues. The unexpected rights announced during noon yesterday crashed its share price (-26.7%) which could hamper the fund raising objectives as the discount from current share price to ex-rights price has narrowed substantially (from 31% discount when cum-price was RM0.84 to 6.5% when cum-price is RM0.62). This has also reduced the overall appeal for existing shareholders to participate in the exercise.

Tweak FY22E earnings higher by 6% (+RM1.5m) to factor in the potential interest savings starting 2HCY22. **Downgrade to MP (from OP) with lowered SoP Cum/Ex TP of RM0.60/0.565 (from RM1.25)** after: (i) completely omitting valuations for its infrastructure division due to poor execution and potential impairments, (ii) factoring in a 25% holding discount to FAVCO, and (iii) increasing the WACC of its airports to 15% from 10%. While current share price does provide a bargain for a recovery play at its Cambodian airports, the immediate concern over this rights proposal and potential cash-flows constraint may pose as an overhang for the stock.

Share Price Performance



KLCI	1,550.17
YTD KLCI chg	-1.1%
YTD stock price chg	-24.4%

Stock Information

Shariah Compliant	Yes
Bloomberg Ticker	MUHI MK Equity
Market Cap (RM m)	299.7
Shares Outstanding	483.4
52-week range (H)	1.21
52-week range (L)	0.62
3-mth avg daily vol:	821,805
Free Float	65%
Beta	1.2

Major Shareholders

Mac Ngan Boon	15.4%
Fil Limited	8.8%
Fidelity Funds Asean	6.7%

Summary Earnings Table

FYE Dec (RM m)	2020A	2021E	2022E
Turnover	**1189.6**	**962.0**	**1133.3**
EBIT	-49.5	36.9	29.2
PBT	-42.8	-20.2	64.0
Net Profit (NP)	**-83.6**	**-19.8**	**25.5**
Core NP	**-72.3**	**-19.8**	**25.5**
Consensus (CNP)	n.a.	-6.1	28.0
Earnings Revision	n.a.	0%	+6%
EPS (sen)	-25.5	-4.1	3.5
EPS growth (%)	-424.8	-83.8	-185.3
NDPS (sen)	0.0	0.0	0.0
NTA/Share (RM)	2.2	2.2	1.5
PER (x)	-2.4	-15.0	17.7
Price/NTA (x)	0.3	0.3	0.4
Net Gearing (x)	0.5	0.3	0.3
Dividend Yield (%)	0.0	0.0	0.0

Risks to our call include: (i) lower-than-expected order-book replenishment target, (ii) delays in construction progress, and (iii) sharp spike in raw material costs.

Sum-of-parts valuations (Old)

Divisions	Stake (%)	Value (RM m)	Effective Value (RM m)	Value/Share (RM/share)	Assumptions
Construction	100%	178	37	0.08	0.2x FY21 PBV (-2.5SD) based on historical 3 years
FAVCO	59%	502	297	0.61	FY21 PER of 11x
Concession/ Societe Concessionaire De l' Aeroport	21%		270	0.56	DCF only for Sihanoukville and Siam Reap airports starting 2022 (WACC at 10%). Assumed Phnom Penh forced to close with compensation suffice to only cover outstanding debt – hence, omitted from our valuations.
		Share Base		**485m**	
		Total	**605**	**1.25**	

Source: Kenanga Research

Sum-of-parts valuations (New) – after accounting for rights issuance

Divisions	Stake (%)	Value (RM m)	Effective Value (RM m)	Value/Share (RM/share)	Assumptions
Construction	100%	0	0	0.0	Omitted
FAVCO	59%	376	223	0.31	FY21 PER of 11x [+ apply 25% holding discount]
Concession/ Societe Concessionaire De l' Aeroport	21%		189	0.26	DCF only for Sihanoukville and Siam Reap airports starting 2022 (Wacc at 15%). Assumed Phnom Penh forced to close with compensation suffice to only cover outstanding debt – hence, omitted from our valuations.
		Share Base		**727m**	**+242m new rights shares**
		Total	**412**	**0.565**	**Ex-Rights TP**
				0.600	**Cum Rights TP**

Source: Kenanga Research

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Peer Comparison

Name	Last Price (RM)	Market Cap (RM'm)	Shariah Compliant	Current FYE	PER (x) - Core Earnings			PBV (x)		ROE (%)	Net Div Yld (%)	Target Price	Rating
					Hist.	1-Yr. Fwd.	2-Yr. Fwd.	Hist.	1-Yr. Fwd.	1-Yr. Fwd.	1-Yr. Fwd.		
STOCKS UNDER COVERAGE													
GAMUDA BHD	2.90	7,289.2	Y	07/2022	12.1	12.1	13.1	0.8	0.8	6.8%	2.1%	2.80	MP
HOCK SENG LEE BERHAD	1.34	736.4	Y	12/2021	23.1	18.4	14.0	0.9	0.9	4.8%	1.1%	0.950	MP
IJM CORP BHD	1.50	5,336.2	Y	03/2022	14.9	29.5	18.2	0.6	0.5	9.9%	14.0%	1.90	OP
KERJAYA PROSPEK GROUP BHD	1.21	1,496.6	Y	12/2021	16.5	15.9	9.5	1.5	1.4	9.1%	2.2%	1.50	OP
KIMLUN CORP BHD	0.790	279.2	Y	12/2021	17.6	18.5	5.7	0.4	0.4	2.2%	2.2%	1.25	OP
MUHIBBAH ENGINEERING (M) BHD	0.620	299.7	Y	12/2021	N.A.	N.A.	17.7	0.3	0.2	-1.7%	0.0%	0.600	MP
SUNWAY CONSTRUCTION GROUP BHD	1.51	1,946.9	Y	12/2021	23.6	22.2	15.3	3.1	2.9	13.3%	2.6%	1.52	MP
WCT HOLDINGS BHD	0.530	751.1	Y	12/2021	N.A.	31.9	8.5	0.3	0.2	2.3%	0.0%	0.620	MP
Simple Average					**18.0**	**21.2**	**12.7**	**1.0**	**0.9**	**5.8%**	**3.0%**		

Source: Bloomberg, Kenanga Research

Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

*******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.***

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