05 April 2016 | Dry Bulk Shipping Update

Malaysia Bulk Carriers Berhad

Prospects improving with firmer charter rates

Upgrade to BUY

Revised* Target Price (TP): *RM1.04
(Previously NEUTRAL with TP of RM0.59)

INVESTMENT HIGHLIGHTS

- **BDI has risen +48% since hitting its lows**
- **Demand for dry bulk shipping seen outpacing supply growth**
- **Previous impairments to cushion Maybulk from large losses**
- **Oil & gas OSV provider POSH shows signs of improvement**
- **Upgrade to BUY with TP of RM1.04 (previously RM0.59)**

BDI has risen +48% since hitting its lows. The Baltic Dry Index (BDI), which measures charter rates across dry bulk ship sizes and routes bounced off its low of 290 on 10/2/2016 to hit 429 (+48%) on 31/3/2016. While the current BDI is still -40% below 2015's average of 718, we believe there could be room for upside as Chinese steelmakers' increase demand for higher grade imported iron ore (79% of iron ore consumed in China is imported). Meanwhile, dry bulk shipping overcapacity issues are set to ease with forecasted net capacity addition of +1.3%, versus a higher +2.4% growth in demand. This bodes well for Malaysia Bulk Carriers Berhad (Maybulk).

China factory activity back on expansion mode. The manufacturing purchasing managers index (PMI) rose into expansionary territory (>50) at 50.2 in Mar 2016, the highest level since Jun 2015 and after 7 months of continuous contraction. Manufacturing activity in China is an important gauge to the health of the dry bulk shipping industry as China is the largest importer of dry bulk commodities such as iron ore (production of steel) and coal (generation of electricity).

Run up in iron ore prices a signal of stronger demand? Iron ore prices at the port of Qingdao rose +40% off its lows of ~US$40/mt in Jan 2016 to trade at US$55/mt as at end-Mar 2016. The sharp rise in prices despite declines in iron ore imports (as of Feb 2016) and crude steel output (as of Dec 2015 data) could be reflective of higher anticipated demand for iron ore while supply remains largely constant.

Chinese steelmakers increasing production despite government curbs. One of China's largest steelmakers, Baosteel announced plans to increase steel production by up to +20% in 2016. The increase in production is underpinned by total steel inventory in China hovering at historically low levels prompting a potential build-up in inventory running into its seasonally higher mid-year period. Meanwhile, we believe that the Chinese government's plans to curb excesses in the steel and coal industry could be positive in the long-run as it reduces the occurrence of painful boom-and-bust swings.

RETURN STATS	
Price (4 Apr 2016)	RM0.78
Target Price	RM1.04
Expected Share Price Return	+33.3%
Expected Dividend Yield	-
Expected Total Return	**+33.3%**

STOCK INFO	
KLCI	1,725.74
Bursa / Bloomberg	5077 / MBC MK
Board / Sector	Main/Trading Services
Syariah Compliant	Yes
Issued shares (mil)	1,000.0
Par Value (RM)	0.25
Market cap. (RM'm)	780.00
Price over NA	0.66
52-wk price Range	RM0.51 - RM1.27
Beta (against KLCI)	1.37
3-mth Avg Daily Vol	2.83m
3-mth Avg Daily Value	RM1.89m
Major Shareholders	
Kuok (Singapore) Ltd.	34.46%
Minister of Finance	18.39%
PPB Group Bhd	14.00%

Recall that management took prudent measures in 4QFY15 to impair various items on its balance sheet including: 1) -RM110.8 for onerous contracts based on the estimated losses for chartered-in vessels within the next 18 months; 2) -RM368.1m write down of the value of its owned vessels taking into account current charter rates and resale values; and 3) impairment of -RM495.8m on investment in 21% associate, PACC Offshore Services Holdings Ltd (POSH).

The impairments will cushion Maybulk from large losses in the future. We believe that with the impairments done, Maybulk has assumed the worst in terms of charter rates for its vessels. Thus, minor declines or a persistence of the current low rates would unlikely cause large losses for its in-chartered fleet (28% of total dry bulk tonnage). Meanwhile, Maybulk will likely suffer only small losses on disposal (if any) should it decide to sell its vessels on the secondary market with an impairment done on its owned fleet to its net realisable value.

Impairment conducted in 4QFY15	Effect on future earnings
-RM110.8 impairment for onerous contracts for chartered-in vessels	Minor declines or a persistence of the current low rates would cushion large losses for its in-chartered fleet
-RM368.1m write down of the value of its owned vessels	Shielded from large losses on disposal should Maybulk dispose vessels which it owns
-RM495.8m write down on investment in 21% associate, PACC Offshore Services Holdings Ltd (POSH)	Losses on disposal contained should Maybulk pare its stake in its associate

Oil & gas OSV provider POSH shows signs of improvement. Having gained 22% year-to-date, SGX listed POSH added another contract win in 2016, securing a 1-year extension for its Xanadu semi-submersible accommodation vessel (SSAV) to Petrobras. This adds to POSH's previous contract win in Feb 2016 amounting US$85m for the long-term charter of 5 vessels to Saudi Arabian and Qatari clients scheduled to commence in FY16-FY17. POSH's vessels remain a top choice for international oil majors.

Upgrade to BUY with higher TP of RM1.04 (previously RM0.59). We are upgrading our call to BUY with higher target price of RM1.04 based on 5-year average price-to-book (PB) ratio of 0.88x (previously SOP method). We believe that the worst could be over for the dry bulk shipping sector and that valuations for Maybulk should revert to its 5-year mean. In addition, Maybulk has taken steps to impair various items on its balance sheet making PB valuation more reflective of current market prices and conditions.

INVESTMENT STATISTICS

FYE Dec	FY13	FY14	FY15	FY16F	FY17F
Revenue (RM' m)	246.7	255.7	160.9	282.9	311.4
EBIT (RM'm)	52.5	23.7	(502.5)	(25.0)	24.6
Pretax Profit (RM' m)	51.3	18.3	(1,038.3)	(29.0)	20.6
Net Profit (RM' m)	50.2	17.5	(1,197.4)	(27.5)	19.6
Core Profit (RM'm)	32.2	1.5	(107.8)	(27.5)	19.6
EPS (sen)	5.0	1.7	(10.8)	(2.8)	2.0
EPS growth (%)	(23.8)	(65.3)	(717.4)	74.5	171.0
PER (x)	15.0	43.2	(7.0)	(27.4)	38.6
Net Dividend (sen)	3.0	1.0	0.0	0.0	1.0
Net Dividend Yield (%)	4.0	1.3	0.0	0.0	1.3

Source: Company, MIDFR

DAILY PRICE CHART

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Source: Bloomberg

5-year rolling PB ratio

Source: Company, Bloomberg, MIDFR

Figure 1: Baltic Dry Index (BDI)

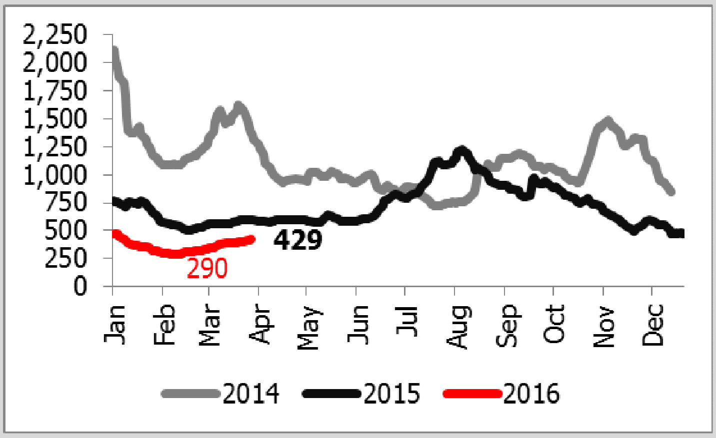
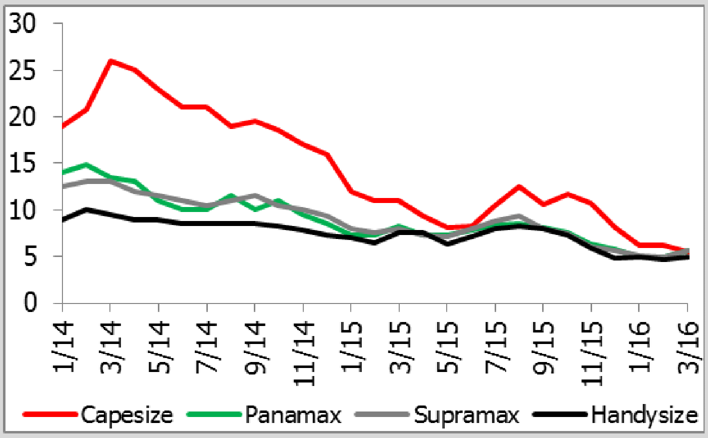


Figure 2: Monthly Average 1-year TC rate for Dry Bulk Carriers, (US$'000/day)



Source: Baltic Exchange, Ship Brokers' Reports, MIDFR

Figure 3: China Manufacturing PMI

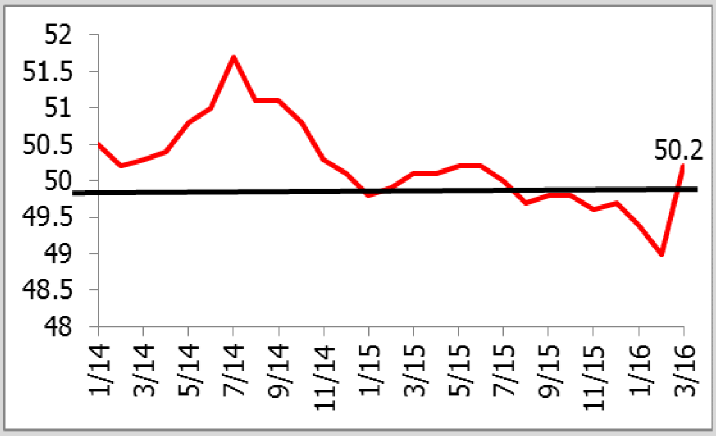
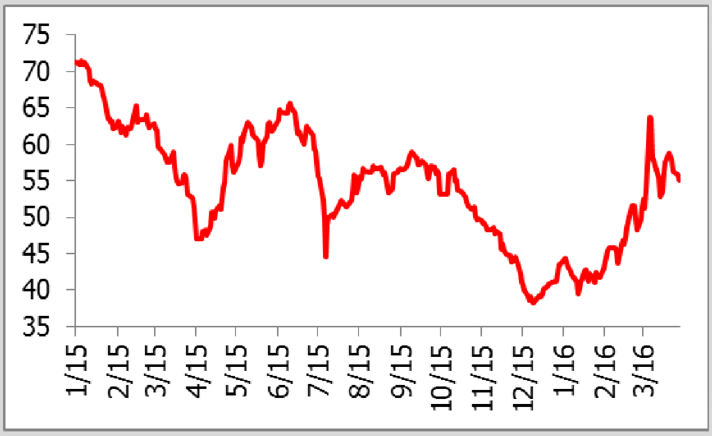


Figure 4: Qingdao Port Iron Ore Price, US$/mt



Source: Bloomberg, MIDFR

Figure 5: China Volume of Commodity Imports - Iron Ore & Concentrate (Million Tonnes, MT)

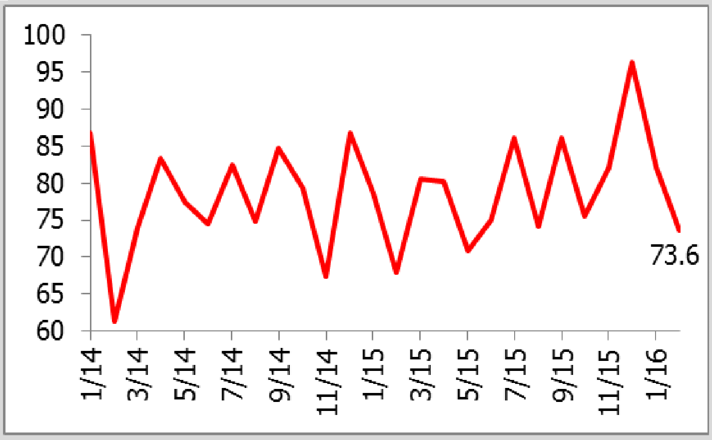
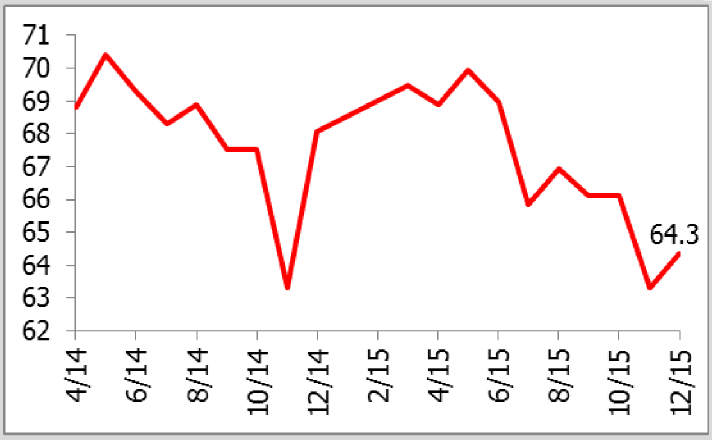


Figure 6: China Crude Steel Output (Million Tonnes, MT)



Source: Bloomberg, China Customs , MIDFR

Figure 7: China Weekly Total Steel Inventory, (10,000 Tonnes)

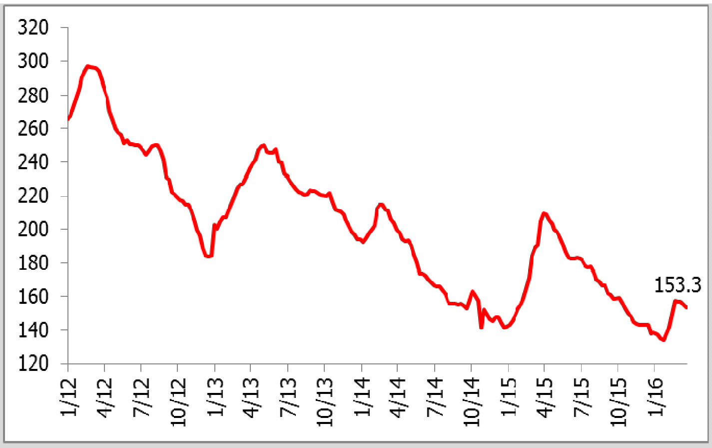
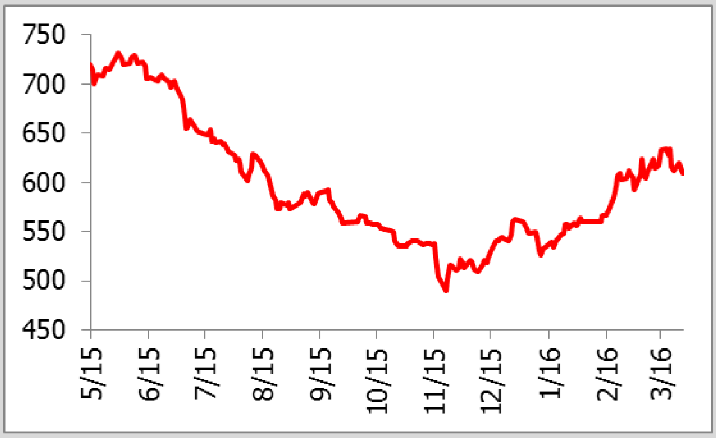


Figure 8: Coking Coal Futures, CNY/mt



Source: Bloomberg, Dalian Commodity Exchange, China Customs, MIDFR

Figure 9: China Volume of Commodity Imports - Coal & Brown Coal (Million Tonnes, MT)

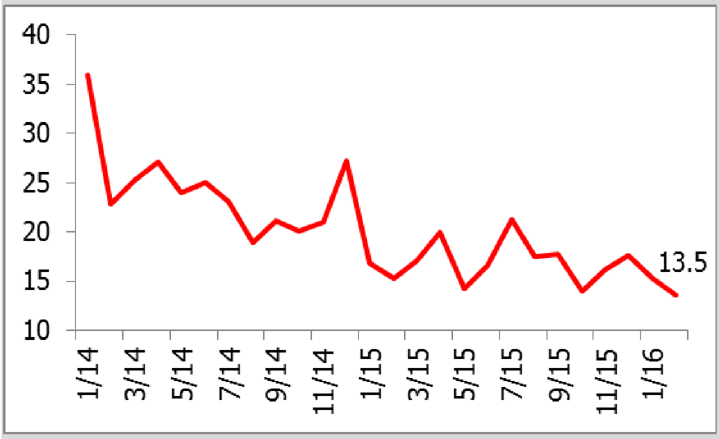
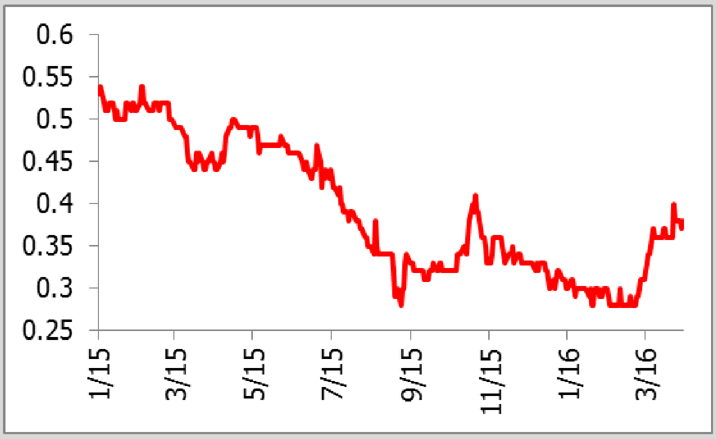


Figure 10: PACC Offshore Services Holdings Ltd Share Price (SGD)



Source: Bloomberg, Dalian Commodity Exchange, MIDFR

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STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	Total return is expected to be <-15% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >15% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.