

Malaysia Company Focus

MKH Bhd

Bloomberg: MKH MK | Reuters: METR.KL

Refer to important disclosures at the end of this report

DBS Group Research . Equity

22 Jul 2015

BUY

Last Traded Price: RM2.18 KLCI : 1,736.19

Price Target : RM3.80 (74% upside)

Reason for Report : Company update

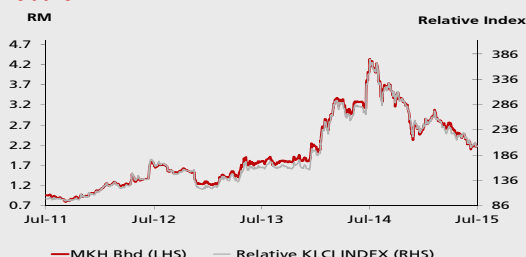
Potential Catalyst: Higher property sales and CPO prices

Where we differ: The only broker covering the stock

Analyst

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Price Relative



Forecasts and Valuation

FY Sep (RM m)	2014A	2015F	2016F	2017F
Revenue	807	807	1,040	1,023
EBITDA	220	235	299	311
Pre-tax Profit	161	177	237	246
Net Profit	102	115	156	172
Net Pft (Pre Ex.)	103	115	156	172
EPS (sen)	24.4	27.5	37.3	41.0
EPS Pre Ex. (sen)	24.5	27.5	37.3	41.0
EPS Gth (%)	(1)	13	35	10
EPS Gth Pre Ex (%)	(14)	12	35	10
Diluted EPS (sen)	24.4	27.5	37.3	41.0
Net DPS (sen)	8.0	8.0	10.0	12.5
BV Per Share (sen)	246.3	265.8	295.1	326.1
PE (X)	8.9	7.9	5.8	5.3
PE Pre Ex. (X)	8.9	7.9	5.8	5.3
P/Cash Flow (X)	4.8	3.4	6.8	3.9
EV/EBITDA (X)	6.1	5.4	4.4	4.1
Net Div Yield (%)	3.7	3.7	4.6	5.7
P/Book Value (X)	0.9	0.8	0.7	0.7
Net Debt/Equity (X)	0.4	0.3	0.3	0.2
ROAE (%)	10.3	10.8	13.3	13.2

Earnings Rev (%):

0 0 0

Consensus EPS (sen):

28.0 37.0 41.0

Other Broker Recs:

B: 1 S: 0 H: 0

ICB Industry : Real Estate

ICB Sector: Real Estate Investment & Services

Principal Business: MKH is an established township developer in Kajang/Semenyih and Greater Klang Valley. Its 16k ha oil palm estates in Indonesia has started to contribute significantly

Source of all data: Company, AllianceDBS, Bloomberg Finance L.P.

Opportunity doesn't knock twice

- Attractive entry opportunity at bargain valuation
- Record high unbilled sales; FY15 property sales remains encouraging
- Young oil palm tree profile will benefit from an upturn in CPO price
- Maintain Buy and RM3.80 TP

Accumulate on price weakness. MKH is now trading at bargain valuation of 6x FY16F PE, 0.8x P/BV, and 60% discount to our SOP valuation. This is not justified given the group's sound earnings prospects. The current valuation implies that its fully-planted 16k ha oil palm estates in East Kalimantan is largely ignored by investors. Assuming US\$20k/ha market price, the estate is worth up to RM1.1bn, a reasonable price for a young estate (trees average six years old) that is commanding impressive operational statistics of 24 MT/ha and 21% OER.

Robust demand for affordable homes. Unbilled property sales have reached a record high of RM843m (as at Mar15), representing 1.6x FY15 property revenue. We understand property sales reached RM600m as at June, and are on track to meet its FY15 target of RM850m. This is largely driven by its focus on affordable homes which remain popular with buy-to-stay homebuyers. MKH's property crown jewel is the 220-acre Kajang 2 flagship development, where more projects will be rolled out closer to the completion of the MRT in 2017. We conservatively estimate the land alone is worth over RM300m.

Time to reap sweet harvest. The plantation business is already self-sustaining, and the group has started servicing its US\$85m borrowings (US\$3.275m/quarter) since March. Thanks to the young tree profile, 1HFY15 FFB volume grew 41% y-o-y and helped to offset the impact of low CPO price. A sustainable recovery of CPO price will be a major catalyst for MKH because of naturally high operating leverage for the plantation business.

At A Glance

Issued Capital (m shrs)	419
Mkt. Cap (RMm/US\$m)	914 / 240
Major Shareholders	
Chen Choy & Sons Realty (%)	43.1
Public Bank Grp Off Fund (%)	9.8
Free Float (%)	47.1
3m Avg. Daily Val (US\$m)	0.12

INVESTMENT THESIS

Profile	Rationale
<p>MKH is an established township developer in Kajang/Semenyih and Greater Klang Valley. Its 16k ha of oil palm estates in Indonesia have started to contribute significantly.</p>	<p>Strong earnings visibility</p> <ul style="list-style-type: none"> Unbilled sales of RM843m (1.6x FY15F property revenue) will underpin near-term earnings visibility. Despite the cautious sentiment, MKH achieved commendable RM208m property sales in 2QFY15 (vs RM87m in 1QFY15) by focusing on affordable homes. This implies it will meet its RM850m sales target for FY15. <p>Plantation earnings intact</p> <ul style="list-style-type: none"> 2QFY15 is a seasonally slow quarter for plantations, but the outlook for 2HFY15 remains promising. We assumed 16% and 12% FFB volume growth for FY15 and FY16, respectively. Volume will continue to grow for the next 2-3 years before the estates start to mature and provide steady recurring earnings to MKH. <p>Largest beneficiary of MRT project</p> <ul style="list-style-type: none"> MKH's strong foothold in Kajang/Semenyih makes it the largest beneficiary of the improved public transport connectivity via two MRT stations within Kajang. This has boosted its property sales. MKH has the distinct advantage of low land cost within the growing Kajang-Semenyih corridor, which will give them greater pricing flexibility.
Valuation	Risks
<p>We maintain our SOP-derived TP of RM3.80 based on 50% discount to property RNAV and DCF valuation for plantation. We continue to like MKH for its undemanding valuation as well as clear earnings visibility anchored by twin drivers, property and plantations.</p>	<p>Margin compression</p> <ul style="list-style-type: none"> Rising construction cost could erode profit margins for property projects. Exposure to fluctuations in CPO prices could make margins more volatile. <p>Weaker property sales</p> <ul style="list-style-type: none"> Rising household debt and softer consumer sentiment may lead to lower property sales.

Source: AllianceDBS

Strong fundamentals intact

Bargain valuation. Notwithstanding the weak sentiment in the property market, MKH's share price has been unfairly punished by investors. Its market capitalisation has shrunk by 45% over the past 12 months. But its fundamentals are intact, and the price weakness offers an attractive opportunity to accumulate the stock. Our SOP valuation assumes a conservative 50% discount to its property RNAV, while the plantation business is valued using the DCF methodology (8.7% WACC, 1.5% TG).

SOP valuation

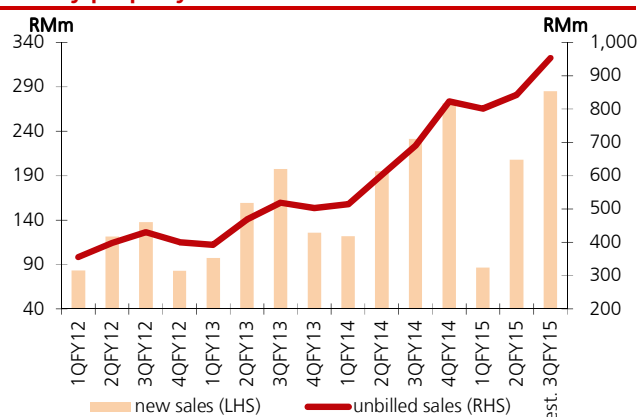
SOP	RMm	RM/share	Remarks
Shareholders fund	449	1.07	Exclude plantation NAV; 50% discount
Land bank surplus	94	0.22	50% discount
Property unbilled sales	42	0.10	50% discount
NPV of near-term projects	196	0.47	Assumed RM3bn sales till FY2020; 50% discount
Plantation	889	2.12	95% stake; DCF (WACC 8.7%, TG 1.5%)
	1,671	3.99	
Warrant proceeds	66	-	conversion@RM1.89
Total	1,736	3.82	Fully diluted basis
	TP	3.80	

Source: Company

Long-term earnings visibility. MKH still has more than 1,400 acres of land bank, about half of which is located in the booming Kajang-Semenyih growth corridor, spurred by the development of MRT connectivity. The land bank will generate >RM10bn in GDV and underpins earnings visibility for more than 10 years. However, MKH continues to actively scout for strategic land bank.

Focus on affordable housing. MKH's property sales have been resilient over the past two years despite the slower market, thanks to its focus on affordable homes, in which the group has a good track record. MKH never employed the Developers' Interest Bearing Scheme (DIBS) when its peers introduced the incentive package in the past few years to attract buyers. This suggests the focus on affordable homes has helped to boost its sales.

Healthy property sales



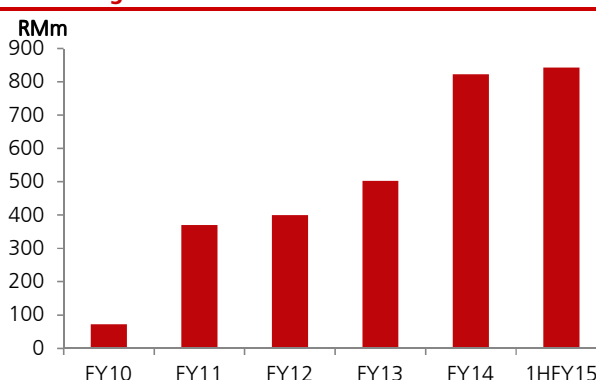
Source: AllianceDBS, Company

Planned launches in FY15

FY15 launches	GDV (RMm)	Timeline
Pelangi Semenyih 2	122	2QFY15
Hillpark @ Shah Alam North	487	3QFY15
Hillpark Homes 3	63	3QFY15
Kajang East	87	2QFY15
Pelangi Height	67	2QFY15
Saville @ Cheras	286	3QFY15
	1,112	

Source: AllianceDBS, Company

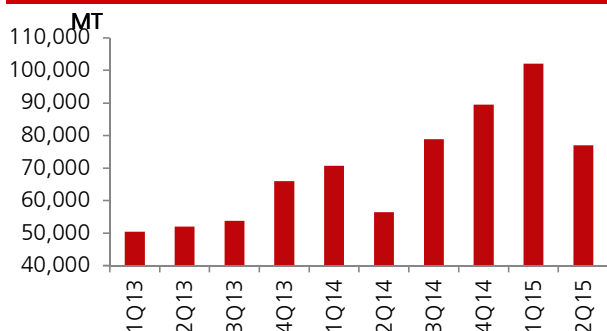
Record high unbilled sales



Source: AllianceDBS, Company

Focus on FFB volume growth. The bearish CPO price trend has dragged MKH's plantation earnings, but we would focus on FFB production at its young estates, which have been registering exponential growth. 1H FY15 FFB volume grew 41% y-o-y and had helped to offset the impact of low CPO price. We assumed 16% and 12% FFB volume growth for FY15 and FY16, respectively. Volume will continue to grow in the next 2-3 years before the estates start to mature and provide steady recurring earnings to MKH.

Exponential growth for FFB production



Source: AllianceDBS, Company

Recovery of CPO price will boost earnings substantially. The impact of stronger CPO price will be multi-fold given the high operating leverage in the plantation business, coupled with rising FFB production. We estimate a 5% increase in our FY16F CPO price assumption of RM2,350/MT would lift FY16F earnings by 3.4%. We imputed a 6% discount to DBS' forecast CPO price to account for lower realised ASP in Indonesia.

Earnings sensitivity to CPO price

CPO price	Profit (RMm)		Profit change %	
	FY15F	FY16F	FY15F	FY16F
+10%	124.3	166.9	7.7%	6.8%
+5%	119.8	161.6	3.9%	3.4%
base case	115.4	156.3	0.0%	0.0%
-5%	110.9	151.0	-3.9%	-3.4%
-10%	106.4	145.7	-7.7%	-6.8%

Source: AllianceDBS, Company

Plantations' quarterly earnings to improve. 2QFY15 plantation earnings disappointed because of delayed sales of CPO in view of the weak selling price. But, we understand the group has been accelerating sales in 3QFY15. Earnings would also be lifted by seasonally stronger production in 2H FY15. It achieved 12.5MT/ha in 1H FY15, and is on track to hit its 24MT/ha target for FY15.

Rising plantation contribution. We expect plantation contribution to increase to 33% and 35% of group earnings in FY15 and FY16, respectively (from 31% in FY13). Given the impressive projected FFB output growth, the plantation business could account for 40% of group earnings by FY17. Yet, MKH is the cheapest plantation proxy at 6x PE – an undeserving discount to DBS Malaysia plantation universe average of 20x.

Self-sustaining business with strong cash flow generation. There is unlikely to be major capital spending on the estates going forward, especially after upgrading its palm oil mill to meet rising own FFB production. The strong cash flow may come in handy for further acquisitions or even benefit MKH shareholders in the form of higher dividend payouts.

Plantation DCF valuation (95% stake)

DCF	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23
Operating profit	71.4	95.9	116.3	129.6	141.7	158.1	167.2	168.5	169.6
(-) tax	(17.9)	(24.0)	(29.1)	(32.4)	(35.4)	(39.5)	(41.8)	(42.1)	(42.4)
Operating profit after tax	53.6	71.9	87.2	97.2	106.3	118.6	125.4	126.4	127.2
(+) depreciation	11.9	12.5	13.2	13.8	14.5	15.2	16.0	16.8	17.6
Operating cash flow	65.5	84.5	100.4	111.0	120.8	133.8	141.4	143.2	144.8
(-) capex	(20.0)	(21.4)	(22.9)	(24.5)	(26.2)	(28.1)	(30.0)	(32.1)	(34.4)
Free cash flow	45.5	63.1	77.5	86.5	94.6	105.8	111.4	111.1	110.4
NPV	514.7								
PV of residual value	721.1								
Firm value	1,235.8								
(-) borrowings	300.0								
Equity value	935.8								

Source: AllianceDBS

Key Assumptions

FY Sep	2013A	2014A	2015F	2016F	2017F
CPO ASP (RM/MT)	2,100	2,236	2,160	2,190	2,308
FFB production (MT)	222,000	295,000	340,781	382,445	413,388
property sales (RMm)	581	820	682	762	634

Sensitivity Analysis

	2016
Property sales +/- 1%	Net Profit +/- 1%
CPO price +/- 5%	Net Profit +/- 3%

Segmental Breakdown

FY Sep	2013A	2014A	2015F	2016F	2017F
Revenues (RM m)					
Property development & Hotel & property	476	530	508	692	659
Trading	32	41	43	44	45
Manufacturing	67	57	59	61	62
Plantation	9	12	12	12	12
Total	688	807	807	1,040	1,023

Premised on RM843m unbilled sales as at Mar15

EBIT (RM m)					
Property development & Hotel & property	115	111	122	159	147
Trading	15	18	17	18	18
Manufacturing	4	4	4	4	4
Plantation	0	1	0	0	0
Total	163	193	214	276	285

Rising contribution from plantation

EBIT Margins (%)					
Property development & Hotel & property	24.2	21.0	24.0	23.0	22.3
Trading	46.9	42.5	40.0	40.0	40.0
Manufacturing	6.7	6.7	6.0	6.0	6.0
Plantation	(2.3)	7.2	1.0	1.0	1.5
Total	23.7	23.9	26.5	26.6	27.9

Income Statement (RM m)

FY Sep	2013A	2014A	2015F	2016F	2017F
Revenue	688	807	807	1,040	1,023
Cost of Goods Sold	(441)	(526)	(470)	(632)	(597)
Gross Profit	247	280	337	408	426
Other Opng (Exp)/Inc	(90)	(82)	(123)	(132)	(141)
Operating Profit	158	199	214	276	285
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	11	3	0	0	0
Net Interest (Exp)/Inc	(17)	(39)	(36)	(40)	(40)
Exceptional Gain/(Loss)	(16)	0	0	0	0
Pre-tax Profit	136	161	177	237	246
Tax	(29)	(44)	(44)	(59)	(61)
Minority Interest	(3)	(15)	(18)	(21)	(12)
Preference Dividend	0	0	0	0	0
Net Profit	103	102	115	156	172
Net Profit before Except.	119	103	115	156	172
EBITDA	183	220	235	299	311

Growth

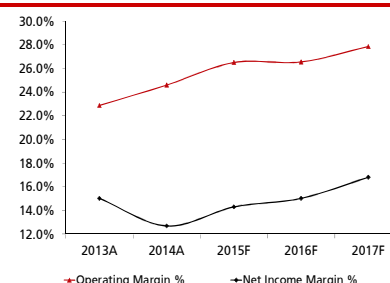
Revenue Gth (%)	26.2	17.2	0.0	28.9	(1.6)
EBITDA Gth (%)	59.8	20.7	6.6	27.4	3.7
Opg Profit Gth (%)	69.7	26.0	7.8	29.1	3.2
Net Profit Gth (%)	38.5	(1.0)	12.7	35.5	10.1

Margins & Ratio

Gross Margins (%)	36.0	34.8	41.7	39.2	41.7
Opg Profit Margin (%)	22.9	24.6	26.5	26.6	27.9
Net Profit Margin (%)	15.0	12.7	14.3	15.0	16.8
ROAE (%)	12.0	10.3	10.8	13.3	13.2
ROA (%)	6.2	5.1	5.2	6.5	6.6
ROCE (%)	8.4	8.3	8.4	10.3	9.9
Div Payout Ratio (%)	25.3	32.8	29.1	26.8	30.5
Net Interest Cover (x)	9.2	5.0	5.9	7.0	7.2

Source: Company, AllianceDBS

Margins Trend



Improving plantation margins

Quarterly / Interim Income Statement (RM m)

FY Sep	2Q2014	3Q2014	4Q2014	1Q2015	2Q2015
Revenue	188	212	224	208	230
Cost of Goods Sold	(113)	(139)	(156)	(134)	(158)
Gross Profit	76	73	68	73	71
Other Oper. (Exp)/Inc	(24)	(23)	(14)	(20)	(27)
Operating Profit	52	50	54	54	44
Other Non Opg (Exp)/Inc	0	0	0	0	0
Associates & JV Inc	1	0	0	0	0
Net Interest (Exp)/Inc	(7)	(7)	(20)	(8)	(9)
Exceptional Gain/(Loss)	29	(22)	6	0	(14)
Pre-tax Profit	75	21	40	47	21
Tax	(19)	(6)	(13)	(11)	(6)
Minority Interest	(5)	(3)	(4)	(5)	(5)
Net Profit	51	12	23	30	11
Net profit bef Except.	21	34	17	30	25
EBITDA	53	50	60	60	51

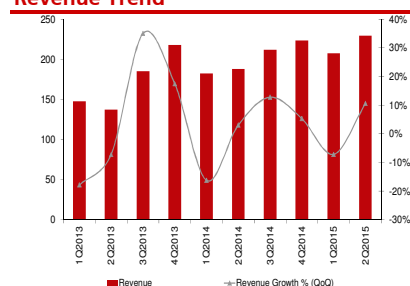
Growth

Revenue Gth (%)	3.1	12.8	5.3	(7.1)	10.6
EBITDA Gth (%)	(1.9)	(4.9)	19.3	0.2	(15.1)
Opg Profit Gth (%)	6.3	(3.3)	8.2	(0.7)	(17.7)
Net Profit Gth (%)	203.1	(77.1)	100.3	29.6	(63.8)

Margins

Gross Margins (%)	40.2	34.3	30.2	35.3	31.0
Opg Profit Margins (%)	27.5	23.5	24.2	25.9	19.2
Net Profit Margins (%)	26.9	5.5	10.4	14.5	4.7

Revenue Trend

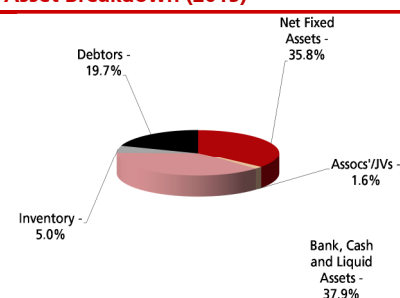


Dragged by plantations segment in 2QFY15

Balance Sheet (RM m)

FY Sep	2013A	2014A	2015F	2016F	2017F
Net Fixed Assets	163	174	273	350	424
Invt in Associates & JVs	28	12	12	12	12
Invt & Devt Properties	264	299	299	299	299
Other LT Assets	713	797	817	838	861
Cash & ST Invt	123	196	289	268	336
Dev Props held for sale	280	372	299	402	379
Inventory	41	38	38	49	48
Debtors	113	150	150	193	190
Other Current Assets	561	688	616	773	746
Total Assets	1,851	2,167	2,306	2,540	2,680
ST Debt	107	131	131	131	131
Creditor	182	262	262	337	332
Other Current Liab	40	56	95	110	112
LT Debt	415	477	477	477	477
Other LT Liabilities	152	186	186	186	186
Shareholder's Equity	951	1,032	1,114	1,237	1,367
Minority Interests	3	23	41	62	74
Total Cap. & Liab.	1,851	2,167	2,306	2,540	2,680
Non-Cash Wkg. Capital	339	371	259	326	303
Net Cash/(Debt)	(399)	(412)	(319)	(340)	(272)
Debtors Turn (avg days)	54.9	59.3	67.7	60.1	68.3
Creditors Turn (avg days)	137.6	159.6	212.5	179.4	213.7
Inventory Turn (avg days)	35.8	28.3	30.8	26.0	30.9
Asset Turnover (x)	0.4	0.4	0.4	0.4	0.4
Current Ratio (x)	2.1	2.0	1.9	1.8	1.9
Quick Ratio (x)	0.7	0.8	0.9	0.8	0.9
Net Debt/Equity (X)	0.4	0.4	0.3	0.3	0.2
Net Debt/Equity ex MI (X)	0.4	0.4	0.3	0.3	0.2
Capex to Debt (%)	33.4	28.6	19.7	16.4	16.4
Z-Score (X)	2.0	1.9	1.9	1.9	2.0

Asset Breakdown (2015)



47% net gearing as at Mar15

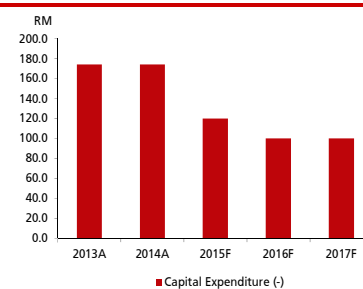
Source: Company, AllianceDBS

Cash Flow Statement (RM m)

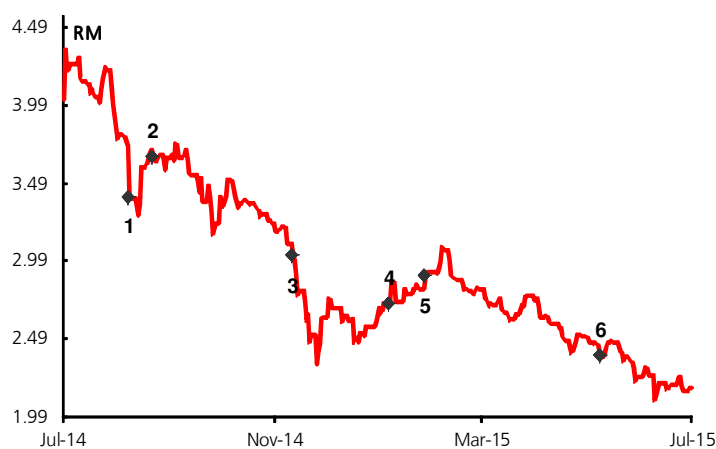
FY Sep	2013A	2014A	2015F	2016F	2017F
Pre-Tax Profit	136	161	177	237	246
Dep. & Amort.	14	19	21	23	25
Tax Paid	(36)	(43)	(5)	(44)	(59)
Assoc. & JV Inc/(loss)	(11)	(3)	0	0	0
Chg in Wkg.Cap.	(6)	53	73	(82)	21
Other Operating CF	13	5	0	0	0
Net Operating CF	109	192	266	134	233
Capital Exp.(net)	(174)	(174)	(120)	(100)	(100)
Other Invts.(net)	(24)	(16)	(20)	(21)	(23)
Invts in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	34	18	0	0	0
Other Investing CF	0	(12)	0	0	0
Net Investing CF	(164)	(184)	(140)	(121)	(123)
Div Paid	(13)	(26)	(34)	(34)	(42)
Chg in Gross Debt	49	84	0	0	0
Capital Issues	52	0	0	0	0
Other Financing CF	0	4	0	0	0
Net Financing CF	88	61	(34)	(34)	(42)
Currency Adjustments	(20)	3	0	0	0
Chg in Cash	13	73	93	(21)	68
Opg CFPS (sen)	27.6	33.2	46.1	51.4	50.6
Free CFPS (sen)	(15.5)	4.3	34.9	8.1	31.7

Source: Company, AllianceDBS

Capital Expenditure



Target Price & Ratings History



Note: Share price and Target price are adjusted for corporate actions.

Source: AllianceDBS

AllianceDBS Research recommendations are based on Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return i.e. > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable catalysts within this time frame)

Share price appreciation + dividends

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