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Corporate Update | Wednesday, 05 February 2020

MSM Malaysia Holdings Berhad

(5202 | MSM MK) Consumer products and services | Food & Beverages

Business fundamentals to improve gradually

***Upgrade to* NEUTRAL**

(previously SELL)

***Revised* Target Price: RM0.81**

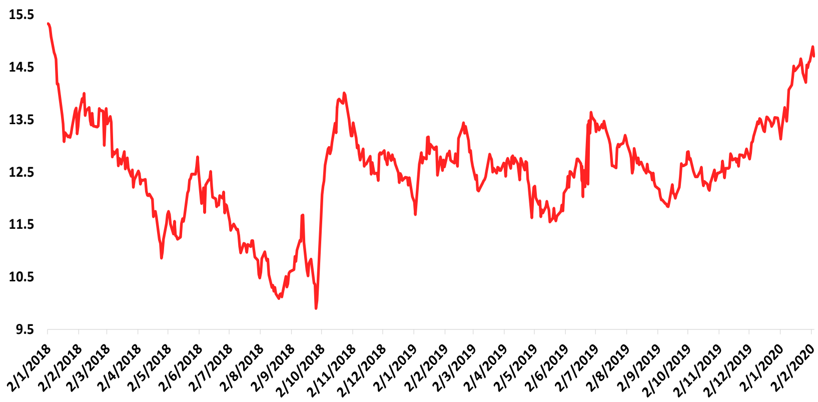
(*previously RM0.70*)

KEY INVESTMENT HIGHLIGHTS

- **Global deficit of sugar to lead to upward movement in raw sugar price**
- **Favourable sugar market conditions are expected to increase MSM's ASP of refined sugars and sales volume**
- **Main areas of focus in FY20 will include prudent cost management, expanding its product lines, and increase the utilization rate of its Johor refinery**
- **We are revising upwards our earnings forecast for FY20 and FY21 in view of the expected improving fundamentals**
- **Upgrade to NEUTRAL with a revised TP of RM0.81**

Global sugar deficit. The current global sugar market is expected to be facing its largest supply shortage in five years of about -8.2m mt in view of the anticipated production cuts in major sugar-producing countries such as India, Thailand and Central-South (CS) Brazil, EU and China in year 2020. The decline in sugar production is mainly brought about by a combination of poor weather and lower planted area. According to the U.S. Department of Agriculture (USDA), the global stocks are also projected to be trimmed by 5m mt to 50m mt with lower stocks in China, India and Pakistan. India, the world's largest sugar producer, is estimated to decline -6.6m mt to 26.5m mt, due to lower area and yields which caused by the unfavourable dry weather. However, the recent improving rainfall in Maharashtra could be partially helping the production from India to recover gradually. Meanwhile, the increasing diversion of total sugarcane output to be used for ethanol production (c.65%) and less to sugar (c.35% vs c.39% in previous crop) in CS-Brazil is reducing the sugar production in the second-largest sugar producing country. In addition, Thailand being the fourth-largest sugar producing country is also forecasted to lower its output by -3.7m mt to 10.9m mt on lower sugarcane yields and sugar extraction rates due to shortfall of rain. Thus, we view that this landscape presents an opportunity for MSM increase its export market.

Graph 1: Price of Sugar No. 11 Futures (NY11)



Source: Bloomberg, MIDFR

RETURN STATISTICS	
Price @ 4th Feb 2020 (RM)	0.77
Expected share price return (%)	+5.2
Expected dividend yield (%)	+0.0
Expected total return (%)	**+5.2**

SHARE PRICE CHART

Share price performance (%)	Absolute	Relative
1 month	-13.5	-9.2
3 months	-12.5	-17.8
12 months	-67.2	-64.1

KEY STATISTICS	
FBM KLCI	1,535.80
Syariah compliant	Yes
Issue shares (m)	1405.96
Estimated free float (%)	10.59
Market Capitalisation (RM'm)	541.29
52-wk price range	RM 0.75 – RM2.48
Beta vs FBM KLCI (x)	0.58
Monthly velocity (%)	11.02
Monthly volatility (%)	26.63
3-mth average daily volume (m)	0.64
3-mth average daily value (RM'm)	0.59
Top Shareholders (%)	
Felda Global Group	51.00
Koperasi Permodalan Felda	15.28
Skim Amanah Saham Bumiputera	7.49

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Sugar price is expected to remain buoyant. The anticipated supply tightness of sugar in CY20, which is mainly driven by lower global sugar production, especially from India, has lifted the commodity's global price. This is evident from the increase in average raw Sugar No.11 Futures (NY11) to above USD13.00c/lb in the beginning of CY20 as compared to the range of between USD10.00-12.00c/lb in 2HCY19. Currently, the NY11 price is trading at about two-year highs and the market expects prices to stay between USD14.00-15.00c/lb until end of 2QCY20. Premised on this, we expect MSM's profit margin to be improving gradually through higher average selling price (ASP) of its refined sugars as white-sugar prices have risen further than raw-sugar prices in the rally. Currently, the group is in the midst of negotiating a new wholesale business model that could fetch a higher pricing for its refined sugars which is expected to have a gain of RM25m/year. We also understand that the Malaysian government has not been issuing any import permit (AP). We view that the current market price of above USD13.00c/lb would discourage manufacturers to procure directly from abroad. Thus, we opine that this phenomenon could increase MSM's bargaining power in the domestic market where it derives approximately 90% of its revenue through higher pricing and sales volume.

Increasing the utilisation rate of its Johor refinery. At present, the utilisation rate (UR) of its Johor refinery at around 23-24% while the UR of both its Perlis and Prai at above 90%. To recall, the group's high operational cost was largely contributed by the Johor refinery's high interest costs, higher depreciatoin and low UR. As such, the group is embarking on several initiatives to improve the UR at MSM Johor. This includes (i) Possible consolidation of production for the export market in MSM Johor, (ii) Expanding its product portfolio in non-refined sugar segment such as sugar syrup and premix and (iii) Venturing into value-added products such as condensed milk, chocolate confectionary, cranberry and etc. The group also guided MSM Johor's breakeven point at profit before tax (PBT) level is a UR of 50% and it plans to achieve at least 28% in FY20 and 42% by FY22. In addition, the potential product diversification is expected to bring in an additional RM8m at the PBT level as well and various export markets identified such as Singapore, China, Hong Kong, Indonesia, Bangladesh and Pakistan given the location proximity of MSM Johor. Meanwhile, we are of the view that the planned higher UR at MSM Johor could be achieved earlier if the group is able to secure an equity or strategic partnerships to export its sugar products to key markets in FY20.

Undergoing cost regularisation initiatives. The management guided that the group's high raw sugar contracts signed previously has ended and this enables them to renegotiate a better pricing for its raw materials. Thus, we postulate that the cost of sales of the group should be improving moving forward if better terms were reached. In addition, the group has begun implementing "Just in Time" (JIT) mechanism to optimise raw sugar stock level at all its refineries for its raw sugar procurement since January 2020. The new practice is expected to achieve a cost savings of up to RM25m/year. The group also plans to further reduce its refining cost by switching the usage of gas for its raw sugar melting process to biomass. Management guided that the capex for the biomass boilers plan is about RM60m for the next two years. This will lessen the group's dependency on naturas gas by an estimated 50-60%/year which could result in 50% savings in fuel cost and possibly achieve an average refining cost of RM280/mt at 95% utilisation rate. Moving forward, we opine that these cost management plans would help to improve the group's cost structure and better margin.

Earnings estimates. In view of the expected cost savings and improving sugar market conditions, we are expecting MSM's FY20 loss to narrow to RM31.0m and turn profitable (i.e. RM50.0m) in FY21.

Target Price. We are rolling over our valuation base year to FY21 and derive a new target price of **RM0.81** (previously RM0.70). Our valuation is based on forecasted FY21 book value per share of RM1.62 to the price-to-book ratio of 0.5x.

Upgrade to NEUTRAL. The recovery of the global raw sugar price amidst a global sugar deficit has given the group a breather as both the lower sugar stock levels at key markets and that the current premium white sugar prices have over raw sugar price are expected to bode well with the group. As a result, we believe that the group should be able to capitalise on this opportunity to improve its earnings prospects through higher ASP of its refined sugar and sales volume. Coupled with no sight of new AP issued to local manufacturers and increasing global raw sugar prices, this could increase the bargaining power of the group to negotiate a better pricing in its home market. This is attributable to the economies of scale and operational capabilities of the group that could provide the local manufacturers to obtain refined sugars at lower cost than directly procure from the global raw sugar market at current prices. However, we opine that the global raw sugar price would remain stable at this juncture and is highly dependent on the Indian inventory level which is still in surplus from previous two high production season and the relative prices of ethanol in Brazil.

In addition, the cost regularisation initiatives which includes JIT mechanism, reduction of the dependency on gas, negotiate a better raw sugar contracts are expected to increase the group's earnings quality and hence better profit margin moving forward. All in, we are upgrading our recommendation to **NEUTRAL** on the stock from previously SELL.

INVESTMENT STATISTICS

FYE 31st Dec (RM'm)	FY17A	FY18A	FY19F	FY20F	FY21F
Revenue	2,641.5	2,215.5	1,955.0	2,077.2	2,257.4
(LBIT) / EBIT	(2.4)	96.0	(49.0)	40.0	101.0
(LBT) / PBT	(19.6)	60.7	(145.0)	(16.0)	65.0
Net (loss) / Income	(36.3)	35.6	(160.0)	(31.0)	50.0
Core Net (loss) / Income	(35.1)	35.1	(160.0)	(31.0)	50.0
EPS (sen)	n.a.	5.07	n.a.	n.a.	7.11
Core EPS (sen)	n.a.	4.99	n.a.	n.a.	7.11
PER	n.a.	20.7	n.a.	n.a.	10.8
NTA/share (RM)	1.82	1.75	1.67	1.68	1.70
P/NTA	0.58	0.60	0.63	0.46	0.45
ROE (%)	n.a.	1.9	n.a.	n.a.	2.8
ROA (%)	n.a.	0.9	n.a.	n.a.	1.5

Source: Company, MIDFR

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% 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.