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MSM Malaysia Holdings Bhd
(March 23, RM4.69)
Not rated with a fair value (FV) of RM5.25: We gather that its new 2.15 million-tonne capacity sugar refinery is on track for completion by the third quarter ending Sept 30, 2017 (3QFY17) and should see full contribution by 1QFY18.

MSM Malaysia Holdings Bhd

FYE DEC (RM MIL)	2015A	2016E	2017E
Revenue	2,307.3	2,345.7	2,400.0
Ebit	377.3	395.3	409.1
Net profit (NP)	280.8	284.1	284.0
EPS (sen)	39.9	40.4	40.4
BV/Share (RM)	2.9	3.1	3.3
PER	11.7	11.6	11.6
Price/BV (x)	1.6	1.5	1.4
Net gearing (x)	0.1	0.4	0.7
NDPS (sen)	20.0	20.2	20.2
Dividend yield (%)	4.3	4.3	4.3

Source: Kenanga Research

The new plant will nearly triple its existing capacity (1.1 million tonnes) to 3.25 million tonnes, with the bulk of production targeted for export markets including Singapore. Expected capital expenditure of RM1.1 billion will be funded through borrowings. Assuming 50% utilisation in 2018, we expect the new plant to nearly double revenue in FY18 to RM4.38 billion (from RM2.28 billion in FY14) and increase earnings before interest and tax by 80% to RM612.5 million (from RM339.5 million in FY14). We project that post-expansion, borrowings could hit RM1.44 billion for a gross gearing of 0.7 times. Hence, management noted that it is looking into capital raising in order to reduce its gearing level.

Management noted that it is also looking at several potential acquisitions, such as: i) a 32,000ha brownfield Indonesian cane plantation, with five existing mills (of which it plans to close down three of them); ii) 42,000ha of greenfield Sri Lankan plantation land; and iii) an Indonesian sugar refinery. Management mentioned that for some of these acquisitions, it may consider a joint venture or asset swap with its strategic alliance partner. We understand that MSM is looking to raise at least US$400 million (RM1.6 billion) to US$500 million through a cash call to fund its expansion plan.

We gather that MSM is likely to propose at least one cash call for the expansions discussed above for gearing reduction, funding expansion and to widen its share base. Potential structures include a rights issue with possible share splits and we gather that MSM is also exploring an employee share option scheme. All in, we estimate capital injections to hit about RM2.25 billion should MSM go through with its merger and acquisition (M&A) plans, which could increase total equity to RM4.31 billion.

Management noted that its internal hurdle rates for its new refinery and M&A plans are 25% and at least 15% respectively, implying a blended hurdle rate of 18% versus MSM's current return on equity (ROE) of 12.5%. Assuming total expansion cost of RM3.2 billion (RM1.1 billion for the new refinery and RM2.1 billion for M&As) and target gross gearing of 30%, we estimate MSM could raise RM2.25 billion in a one-to-one rights issue to meet its funding needs (assumed a rights issue price of RM3.05 at a 35% discount to the last price of RM4.69 [theoretical ex-rights price of RM3.81]). We also assume the expansion will start contributing from FY18. To maintain MSM's current price-earnings ratio (PER) of 12.7 times, the expected ROE of its expansion plans must be a minimum of 5.5%. However, to ensure FY18 earnings per share (EPS) are accretive, the expected ROE of its expansion plans must be at least 8.8%, implying a FY18E (estimate) PER of 10.2 times. As such, we think that if management can meet its projected hurdle rates for its expansion plans, the cash call is likely to be accretive to shareholders from FY18.

We assign an FV of RM5.25 to MSM based on a target PER of 13 times applied to FY16 EPS of 40.4 sen. Our PER is based on the three-year historical average PER, which we think is fair as MSM's long-term expansion growth potential is offset by short-term higher-gearing levels. Any potential rerating catalyst is dependent on the quality of MSM's potential acquisitions. — *Kenanga Research*, March 23

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