MSM’s Johor refinery on track, explores M&A opportunities

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KUCHING: MSM Malaysia Holdings Bhd’s (MSM) Tanjung Langsat refinery in Johor is on track, the research arm of Kenanga Investment Bank Bhd (Kenanga Research) observes, while the group is also exploring merger and acquisition (M&A) opportunities.

Kenanga Research gathered that MSM’s new circa 2.15 million metric ton (MT) capacity sugar refinery is on track for completion by the third quarter of 2017 (3Q17) and should see full contribution by 1Q18.

According to the research arm, the new plant will nearly triple its existing capacity (1.1 million MT) to 3.25 million MT, with the bulk of production targeted for export markets, including Singapore.

“Expected capex of RM1.1 billion will be funded through borrowings,” it said.

Assuming 50 per cent utilisation in 2018, Kenanga Research expected the new plant to nearly double revenue in FY18 to RM4.38 billion, from RM2.28 billion in financial year 2014 (FY14), and increase the earnings before interest and tax (EBIT) by 80 per cent to RM612.5 million (from RM339.5 million in FY14).

The research arm projected that post-expansion, borrowings could hit RM1.44 billion for a gross gearing of 0.7-fold.

“Hence, management noted that they are looking into capital raising in order to reduce its gearing level post-expansion,” the research arm said.

On exploring M&A opportunities, Kenanga Research higlighted MSM’s management had noted that they are also looking at several potential acquisitions, such as a 32,000 ha brownfield Indonesian cane plantation, with five existing mills (of which they plan to close down three mills), 42,000 ha greenfield Sri Lankan plantation land and an Indonesian sugar refinery.

“Management mentioned that for some of these acquisitions, they may consider a joint venture (JV) or asset swap with its strategic alliance partner.

“We understand that MSM is looking to raise at least US$400-500 million (RM1.7-2.1 billion) through cash call to fund its expansions plan,” the research arm said.

Kenanga Research gathered that MSM is likely to propose at least one cash call for the expansions discussed above to reduce the group’s gearing, fund expansions and widen its share base.

Potential structures include a rights issue with possible share split, and the research arm gathered that MSM is also exploring an employee share option scheme (ESOS) program.

All-in, the research arm estimated capital injections to hit circa RM2.25 billion, should MSM go through with the group's M&A plans, which could increase total equity to RM4.31 billion.

Based on management's guidance, Kenanga Research believed that the key objectives of the capital raising exercise are to raise funds for MSM's expansion plans and reduce gearing to a comfortable level.

"Management noted that its internal hurdle rates for its new refinery and M&A are 25 per cent and at least 15 per cent, respectively, implying a blended hurdle rate of 18 per cent versus MSM's current return on equity (ROE) of 12.5 per cent," the research arm said.