

# MSM's higher-cost inventory expected to trend down

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MSM Malaysia Holdings Bhd

(Jan 17, RM4.08)

**Maintain sell with a higher target price (TP) of RM3.70:** MSM Malaysia Holdings Bhd posted a net loss of RM46 million for the first nine months of 2017 due to a higher average raw sugar cost (US\$18 [RM71.28] to US\$20 cts/lb versus FY16: US\$16 to US\$17 cts/lb). But we understand that the higher-cost inventory is trending down. Management has fully locked in its cost at US\$14 to US\$16 cts/lb for the fourth quarter of 2017 (4Q17), and we expect a stronger 4Q17 sequentially. We forecast that profits can be sustained into FY18 as management has fully covered 50% of the group's total raw sugar requirement for the first half of 2018 at US\$14 to US\$16 cts/lb.

Based on the US Department of Agriculture report in December 2017, global raw sugar production for 2017/2018 is projected to rise 5% to almost 180 million tonnes, compared with a consumption of 170 million tonnes. The record production in response to a production deficit in the past two years will likely lead to a lower global raw sugar price at around US\$14 to US\$16 cts/lb in FY18, as reflected by the forward price of NY sugar No 11.

The new refinery with a capacity of one million tonnes (versus the current capacity of 1.25 million tonnes) is expected to begin production in June 2018, and it will be mainly for the export market. We believe MSM's gross margin will be diluted as the export margin (RM150 per tonne) is much lower than the domestic margin of RM1,000 per tonne. We assume the depreciation and interest expenses for the refinery will weigh on MSM's earnings, especially for FY19.



We reduce our earnings forecasts for FY18 to FY19 by 8% to 11% to adjust for the average selling price and interest expenses. But we now apply a higher price-earnings target of 20 times (from 16 times) to reflect the improvement in the earnings outlook, and raise the TP to RM3.70. We still maintain our "sell" call as we expect limited growth in FY19. Upside risks include favourable hedged raw sugar prices, a sharp increase in sugar ceiling prices and stronger-than-expected demand. — Affin Hwang Capital, Jan 18