Not-so-sweet ride for sugar refiners

Margins will continue to be squeezed by rising costs of production on the back of weaker ringgit

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BESIEGED by the spike in global raw sugar prices, most local sugar-refining players are not expecting a sweet ride this year, as their margins will continue to be squeezed by rising costs of production on the back of the weaker ringgit against the US dollar.

Raw sugar was one of the best-performing commodities in 2016, surging 30% to a four-year high of 24 US cents per pound in October last year. The commodity, which is the main raw material in sugar refining, is currently trading at around 21 cents per pound.

Set to face these headwinds is local sugar refiner MSM Malaysia Holdings Bhd, which controls over 60% of the domestic sugar supply.

Its president and group chief executive officer Mohamad Amri Sahari expects 2017 to remain a challenging year for MSM despite the government's latest move to revise the domestic wholesale and retail prices of coarse grain white refined sugar.

Effective March 1, the maximum wholesale price for coarse grain white refined sugar has been increased by 7% to RM2.87 per kg, while its retail price is up 3.8% to RM2.95 per kg.

The last revision on sugar prices was on Oct 26, 2013.

Mohamad Amri tells *StarBizWeek* that "for almost two years, the industry has been operating in a very weak economic condition.

On track: File picture shows one of MSM's refining facilities. The construction of MSM's new RM1.04bil sugar refinery in Johor is well on track.

He says the situation has been worsened by the spike in global raw sugar prices due to a deficit in the world sugar market and the depreciating ringgit against the greenback.

"These bearish factors have also led to higher production costs by about 40% and adversely affected our operating margins by about 80%.

"Therefore, the recent increase in the wholesale and retail prices of coarsed grain white refined sugar by the Government is indeed timely to somewhat offset the huge jump in the raw material costs of most sugar refiners."

In Malaysia, the two leading sugar-refining players are MSM, which is a subsidiary of Felda Global Ventures Holdings Bhd, and Tradewinds (M) Bhd.

MSM's sugar refineries include Kilang Gula Felda Perlis Sdn Bhd and Malayan Sugar Manufacturing Co Bhd, while Tradewinds owns Central Sugars Refinery Sdn Bhd and Gula Padang Terap Sdn Bhd.

Given the challenges ahead, Mohamad Amri adds that MSM Group would be intensifying its efforts by putting in place an efficient operational management and effective cost management.

In Malaysia, sugar refining is a regulated industry, whereby sugar-refining operators are obligated to ensure adequate sugar supply in the country.

Echoing a similar challenging sentiment, AllianceDBS Research says the sugar refiner's unit production cost is expected to rise by 15% this year due to the weakening ringgit and higher imported raw sugar cost in the US dollar compared with the previous years.

"However, the unit production cost is expected to improve gradually in 2018 once MSM's Dubai office fully manages the purchase of raw sugar for the group, as well as the completion of the group's new Tanjung Pelepas sugar refinery," says the research house in its latest report.

AllianceDBS, however, has upgraded its call on MSM to a "hold" and raised its target price to RM4.70 upon revising upwards the company's 2017 and 2018 earnings to reflect the increased average sugar selling prices.

"We believe that the sugar price hike by the government is timely for the group to pass on the increased cost of raw sugar, and also raise our 2017 and 2018 earnings estimates by 40% to 76%, respectively," adds the research unit.

On the Dubai trading office, Mohamad Amri says it has been operating slightly for more than a year.

"At this infancy stage, our Dubai operation has managed to contribute about 18.35% of MSM's group net profit, surpassing our initial target set for 2016.

"Strategies are in motion to improve the results for the current year," he adds.

He also says that the construction of the group's new RM1.04bil sugar refinery in Johor is well on track.

Barring any unforeseen circumstances, the refinery is expected to be completed by the first quarter of next year.

It was reported that MSM is targeting to increase its domestic market share to 85% by 2018 in line with its aspiration to be a top-10 global sugar player by 2020.

The new sugar refinery will have a production capacity of one million tonnes of refined sugar annually, effectively enabling MSM to increase its annual production capacity to 2.25 million tonnes.

Built on some 20.49ha of land, the facility is expected to provide some 500 job opportunities for locals in the next five years.

Referring to the sugar demand, Malaysia's sugar consumption is expected to rise close to 1.9 million tonnes by 2025 from its current 1.4 million tonnes a year.

The world's two biggest sugar consumers, India and China, are also expected to see growth from 22 million and 16 million tonnes to 40 million and 26 million tonnes, respectively.

On MSM's future expansion to go upstream, Mohamad Amri says any upstream activities shall be reviewed on an opportunistic basis.

"Our priority will be the downstream segment and export growth, which commands higher margins, better growth and less risk," concludes Mohamad Amri.