FGV Holdings Berhad - Bleeding Sugar Business Plaguing the Group

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INVESTMENT HIGHLIGHTS

- **1HFY19 core earnings of –RM43.8m (-428.1%yoy) came in below our and consensus expectations**
- **This was mainly attributable to lower ASP of CPO and dismal financial performance from its sugar business**
- **Fundamentals of its plantation sector operation remain intact amidst the recovery of CPO price into 3QCY19**
- **FY19 and FY20 earnings forecasts revised downward in view of its larger-than-expected losses at its sugar business**
- **Downgrade to NEUTRAL with a revised TP of RM0.96**

1HFY19 earnings below expectations. FGV Holdings Berhad's (FGV) 1HFY19 normalised earnings came in at –RM43.8m which was below our expectation. The poor financial performance of the group was primarily beleaguered by the sustained low ASP of CPO for 1HFY19 and the depressing financial performance of its sugar business segment. However, the fundamentals of its plantation sector remain intact and continue to improve according to its transformation plan.

Plantation division in the red. Plantation division's 1HFY19 profit before zakat and tax (PBZT) took a dip to record losses of –RM14.3m as compared to profit of RM27.0m in the previous year corresponding period. This was mainly due to the decline in ASP of CPO by -19.0%yoy to RM1,972/ metric tonnes (mt) and a higher fair value charge in LLA of RM79.0m. Unfortunately, the higher PBZT contribution from the downstream segment of RM22.0m (+266.0%yoy) was insufficient to mitigate the lower ASP of CPO. However, we are comforted by the fact that fundamentals from its plantation operation remain intact in line with its transformation plan.

Sugar business segment suffered heavy losses. Sugar division posted 1HFY19's LBZT of –RM56.0m as compared to RM50.0m profit in previous financial period. This was predominantly attributable to the heavy losses of about –RM65.0m from its Johor refinery in 2QFY19. The sustained low utilisation rate (i.e. 20-30%) of its Johor refinery has resulted in lower gross profit margin. Coupled with a competitive price war and oversupply of refined sugar in the domestic market, we opine that the sugar sector to continue to predominantly drag the group's overall profitability.

Improving fundamentals is providing some buffer. Despite the unfavourable CPO price environment, the group's encouraging 1HFY19's operational efficiency from its plantation sector partially acts as a mitigating factor. The FFB production and yield have increased by +11.0%yoy and +15.0%yoy to 2,204k mt and 9.14mt/ha respectively. This led to the improvement in CPO production and oil extraction rate (OER) by +17.0%yoy and +2.0%yoy to 1,549k mt and +20.5% respectively. In terms of cost, the ex-mill CPO cost fell by -24.0%yoy to RM1,416/mt as a result of higher FFB production and mill utilisation factor (UF) at 77%. These helped the group to partially cushion the low CPO price. In addition, the group's 2QFY19's recorded higher sales volume for its FMCG segment, biodiesel and oleochemical segment of +13.0%yoy, +45.0%yoy and +7.0%yoy respectively. Moving forward, we are of the view that the group's fundamentals would help to improve its earnings quality given the recent recovery of CPO price into 3QCY19.

Earnings estimate revised downward. We are revising our FY19 and FY20 forecast core earnings downwards to –RM110.4m and –RM75.1m, mainly to take into account the larger-than-expected losses from its sugar sector.

Target Price. Subsequent to our earnings downward revision, we are deriving a new **target price** of **RM0.96** (previously RM1.40). This is achieved by pegging its FY20BVPS of 1.2 to PBV of 0.8x which is one standard deviation below the group's 2-year historical average.

Downgrade to NEUTRAL. The well-being of the group has been beleaguered by the heavy losses from its sugar business (i.e. MSM) as a result of large losses from its Johor refinery amidst a tough operating environment for refined sugars in the domestic market. In addition, the low CPO price has been putting pressure on the group's profitability as well. However, we are encouraged by the progress of the group's transformation plan to improve operational efficiency which is well on-track as evidenced from its positive operational statistics to partially offset the challenging CPO price environment. We also opine that the recent recovery of CPO price into 3QCY19 coupled with improving FFB production is still insufficient to offset the huge losses from its sugar business segment. All in, we are downgrading our recommendation on FGV to **NEUTRAL (previously BUY).**

Source: MIDF Research - 29 Aug 2019

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