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FGV seen looking for strategic equity partner for MSM

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FGV Holdings Bhd
(July 29, RM1.15)
Reiterate buy with an unchanged target price (TP) of RM1.40: FGV Holdings Bhd is looking to sell part of its 51% stake in MSM Malaysia Holdings Bhd (MSM) as part of its rationalisation plan. MSM is currently facing a possible worsening financial performance in view of the domestic refined sugar glut and stiff competition amid the liberalisation of the sugar industry. This would have a negative impact on FGV's profitability going forward.

We understand that the group is looking for a strategic equity partner for MSM rather than to completely exit the sugar business. According to The Edge Financial Daily, the group is engaging with at least four companies including international players in the sugar industry to dispose of approximately half of its 51% stake. The four interested parties include: i) JAG Capital Holdings Sdn Bhd; ii) Wilmar International Ltd; iii) an unnamed Indonesian company; and iv) an unnamed Chinese company. This indicates that both FGV and MSM are looking to expand into mass export markets like China and Indonesia via strategic collaborations with respective local players.

We are positive on the news as it would potentially alleviate the precarious situation that MSM is in at the moment. Should a synergistic strategic equity partnership for MSM materialise, we would most likely observe an improvement in profitability for FGV. We assume the collaboration could benefit MSM in strengthening its foothold in the domestic market or as a conduit to venture further into the international arena. Either way, it would help in easing MSM's excess refinery capacity of approximately one million tonnes from its new refinery in Johor. To recall, we are expecting MSM to be in a loss-making position for the financial year 2019 (FY19) and FY20. This is mainly premised on: 1) expectancy of weak average selling price; 2) global sugar glut; and 3) implementation of a sugar tax on soft drinks and juices.

Assuming the pursuit of strategic alliance for MSM is scrapped, we do not discount the possibility of FGV selling off the MSM Johor sugar refinery to improve its cost structure going forward. This is in view of its low utilisation rate of about 30% and an upward revision of gas tariff which contributed to a higher refinery cost at about RM350 to RM400 per tonne. Coupled with an oversupply of refined sugar and price war in the domestic market continuing, the refinery would only place further downward pressure on MSM's profit margin and adversely affect FGV's profitability. The focus could then be diverted towards enhancing MSM's downstream segment business.

Pending further development, we are making no changes to our earnings forecasts.

We are maintaining our TP of RM1.40 by pegging its FY20 book value of equity per share of 1.27 at price-to-book value of 1.1 times which is the group's five-year historical average.

We remain optimistic about FGV for its relentless focus and execution of its transformation plan for the group to turn around. The outlook of better profit contribution from its sugar business would be promising if the group is able to secure a strategic partner that provides synergistic opportunities into the international sugar market. Should MSM remain in a loss-making position, the reduced stake could help in enhancing FGV's earnings quality.

Earlier this month, the group had also announced the disposal of its loss-making entity, FGV China Oils Ltd in China, which is expected to be completed in early FY20. Nonetheless, the group is seeking to continually expand into the Chinese market via exporting potential higher-margin palm oil and sugar downstream products. We are also of the view that the group could venture further into the downstream segment inorganically. Coupled with its continuous focus on operational efficiency, we believe the group could partially mitigate the current challenging crude palm oil price environment. All factors considered, we are maintaining our "buy" recommendation on FGV. Meanwhile, pending further development, we are maintaining our "sell" recommendation on MSM with an unchanged TP of RM1.07. — MIDF Research, July 29

AGENCY: The Edge Markets (Online)

LINK: https://www.theedgemarkets.com/article/fgv-seen-looking-strategic-equity-partner-msm