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MSM shares rise but exposed to bearish market

Sugar industry developments, lower selling prices and higher refining costs weighed on its earnings

by MARK RAO/ pic by MUHD AMIN NAHARUL

MSM Malaysia Holdings Bhd's share value continued to gain traction on prospects of its main shareholder, bringing in a new investor despite its fundamentals remaining weak due to the challenging domestic market.

FGV Holdings Bhd announced that it is exploring potential collaborations in the palm and sugar industries, including strategic alliances amid reports that the integrated oil palm giant is in talks to dispose of a portion of its 51% stake in MSM.

MSM is Malaysia's leading refined sugar producer, controlling close to 60% of the domestic sugar market, but has been struggling with losses in recent years as industry developments, lower selling prices and higher refining costs weighed on its earnings.

The stake disposal possibility was well-received by investors as shares in both companies made significant gains over the past two trading days.

MSM's shares appreciated by 22 sen or 15.94% higher on Monday to close at RM1.60, while shares in FGV rose four sen or 3.6% to RM1.15.

MSM and FGV have gained RM302.28 million and RM365 million in market capitalisation respectively since last Thursday.

MIDF Research analyst Khoo Zhen Ye said news of FGV to sell a stake in MSM would be a positive development for both parties and partially explains the recent share price movements.

"FGV selling a portion of its shareholding in MSM allows the company to reduce its exposure to the loss-making sugar producer," he told The Malaysian Reserve.

"Bringing in an experienced joint-venture partner for MSM allows FGV to leverage on the new partner's expertise to lower refining costs, thus increase profitability and facilitate an earnings recovery."

He maintained MSM's target price (TP) at RM1.07, pending a material development from the news reports, as the company's fundamentals remain weak.

In a report published early this month, the research firm set the TP for the sugar producer, which is 33% lower than its last closing price, based on its projected book value per share of RM2.14 for the 2020 fiscal year and at a two-year low historical price-to-book ratio of 0.5 times.

The valuation method reflects MSM's negative earnings trajectory in the next two years due to oversupply and high competition in the domestic sugar market following the liberalisation of Malaysia's sugar industry.

The research firm also maintains a 'Sell' coverage for MSM due to the prolonged oversupply of refined sugar in the domestic market where the company derives 90% of its sales revenue.

MSM registered its second consecutive quarter of losses for the period ended March 31, 2019 (1Q19), falling to a RM7.06 million net loss against a RM15.81 million profit in 1Q18, due to higher refining costs and lower average selling prices.

The latter resulted in turnover for the group contracting 11.5% year-on-year to RM485.62 million.

Local industry developments have not helped the company as the implementation of the sugar tax in July is expected to see local food and beverage (F&B) manufacturers reduce their sugar usage to mitigate the higher costs.

Meanwhile, the issuance of new permits for sugar imports late last year, which is estimated to have brought some 80,000 to 100,000 metric tonnes of additional sugar into the domestic market, is weighing on MSM's sales.

The sugar producer, however, is aiming to increase exports by moving into the downstream segment, specifically the production of higher margin sugar-based products for markets abroad.

Since its Johor refinery came on stream this year, MSM's total refining capacity has risen to 2.2 million tonnes per annum and is slated to meet both domestic requirements and new opportunities to export.

For FGV, selling a portion of its stake in MSM would be in line with its transformation plan which includes reviewing all under- and non-performing assets, especially legacy investments.

It recently inked an agreement to sell its loss-making subsidiary in China, namely FGV China Oils Ltd, for RM100 million as part of ongoing rationalisation efforts.

The China-based subsidiary has been loss-making since the Malaysian planter acquired the asset back in 2005, raking up a total of RM120.25 million in losses from 2016 to 2018, due to heightened competition from regional suppliers

FGV itself is struggling with losses and high debt, posting a RM1.08 billion net loss last year, while total liabilities stood at RM12.64 billion in 1Q19 and assets were higher at RM19.21 billion.

AGENCY: The Malaysian Reserve (Online)

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