Higher CPO prices seen to offset lower FFB output for FGV

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FGV Holdings Bhd
(Feb 11, RM1.35)
Maintain trading buy with an unchanged target price (TP) of RM1.70: We maintain our rating after meeting FGV Holdings Bhd's management. The biggest upside to its earnings could come from a rerating of MSM Malaysia Holdings Bhd's earnings, should it manage to negotiate higher selling prices of its refined sugar in Malaysia. In addition, the disposal of Trurich Resources Sdn Bhd by the end of the first quarter of 2020 (1Q20) will be an added bonus to its bottom line.

Although fresh fruit bunch (FFB) growth for January 2020 is likely to be weak, similar to the Malaysian Palm Oil Board's -12.6% year-on-year (y-o-y), the management expects FFB growth to still be positive at 2%-4% y-o-y for the forecast financial year ending Dec 31, 2020 (FY20F). This should stem from improvements in output in 2Q20, where the management is expecting to see a mini-peak, as well as the normal seasonal peak in the second half of 2020 (2H20). For crude palm oil (CPO) output, however, FGV is targeting a larger 4% to 6% growth on improvements in the oil extraction rate. This is expected to come from the new model and standards it is setting in all its CPO mills and estates, which aim to lower costs by 20% to 30%. This "model mill and estate" project has been rolled out to 40% to 50% of its mills and 25% of its estates in Peninsular Malaysia already. For Sabah, it has just started rolling out the implementation. By end-2020, FGV expects to have implemented these standards across all its operations.

FGV has clinched some forward sales for 4QFY19 at higher prices. It has a policy of selling forward not more than 30% of its CPO produced, given that 30% of output comes from its own estates. We understand some 30,000 tonnes (less than 1% of total CPO output) were sold forward at RM2,800 to RM3,100 a tonne.

We understand FGV is not urgently trying to sell its stake in the Johor sugar refinery now, since it has restructured its debts, its long-term raw sugar contract has been run down, and raw sugar prices are on the way up. This will enable MSM to negotiate for higher selling prices for its retail market as well as the wholesale market. We understand MSM would like to go back to government-gazetted prices of retail and wholesale sugar, which could imply an increase in prices of 20 sen to 25 sen a kg. This, if implemented, will have a significant positive impact on earnings, as every 10 sen a kg change in selling prices will raise earnings by 20% to 30% per annum.

As for FGV's disposal of Trurich, we understand this is targeted to be completed by end-1Q20. There are currently two bidders for the company, with the pricing being finalised now.

There is no change to earnings estimates and sum of parts-based TP remains at RM1.70. We believe 4QFY19 results will be positive, with higher CPO prices offsetting the lower FFB output. In addition, benefits from previous cost-saving initiatives (RM170 million for FY19) will continue to come through for 4QFY19, while we do not expect any major impairments for the quarter. — RHB Research Institute, Feb 11

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