

13 November 2018 | Briefing Note

Fraser & Neave Holdings Berhad

Expected higher tax expense for Thailand operation

INVESTMENT HIGHLIGHTS

- **F&B Malaysia signals recovery in performance post-transformation exercise**
- **Recently introduced sugar tax will not significantly deter F&B Malaysia performance**
- **Nonetheless, expect a lower contribution from F&B Thailand as a result of full utilisation of tax incentives**
- **Maintain NEUTRAL with a revised TP of RM31.54**

Marginal normalised earnings growth for FY18. To recall, Fraser & Neave Holdings Bhd's (F&N)'s full year FY18 normalised earnings grew marginally by +1.5%yoy to RM381.9m. Despite F&B Malaysia's stronger earnings contribution post-transformation exercise and strong overall export growth, earnings was negatively impacted by the lower-than-expected contribution from F&B Thailand.

F&B Malaysia regained stability post-transformation exercise.

The F&B Malaysia segment remains the largest contributor to group's revenue in FY18 at 56.5%. The segment managed to maintain its position post the transformation exercise in FY17 as evident in the previous three consecutive quarters. The transformation entails a leaner structure for the Malaysian operation that minimise process duplication and increase in operation efficiency via the streamlining of the distribution channel for its dairies and soft drinks businesses. Consequently, this gives outlets greater access to F&N products. On another note, the segment recorded a +15%yoy growth in export due to their targeted marketing approach in the oversea halal markets i.e. Middle East and Africa.

Sugar tax will not have a significant impact on F&B Malaysia.

While management acknowledged that the sugar tax is a negative development for F&N, their concern is more directed towards the effective date of the implementation which is on 1st April 2019. This is deemed too early as the group require more time to respond either through sourcing alternative substitute to sugar or reformulation of products' recipe. Hence, we expect a lower contribution from soft drink products in FY19. Nonetheless, this will not significantly impact F&B Malaysia performance as: (i) the dairy segment continues to be its main earnings driver and; (ii) the group will benefit from the cost savings generated from greater efficiency.

Maintain NEUTRAL
Revised Target Price (TP):RM31.54
(Previously RM34.52)


RETURN STATS	
Price (12 th November 2018)	RM33.62
Target Price	RM31.54
Expected Share Price Return	-6.2%
Expected Dividend Yield	+2.2%
Expected Total Return	-4.0%

STOCK INFO	
KLCI	1,696.14
Bursa / Bloomberg	3689 / FNH MK
Board / Sector	Main / Consumer
Syariah Compliant	Yes
Issued shares	366.54m
Market cap. (RM'm)	12,323.12m
Price over NA (x)	5.33
52-wk price Range	RM24.6 –RM40.0
Beta (against KLCI)	0.72
3-mth Avg Daily Vol	0.30m
3-mth Avg Daily Value (RM'm)	11.2m
Major Shareholders (%)	
Fraser and Neave Ltd	55.51
EPF	12.45
PNB & Associated funds	6.59

F&B Thailand will be subjected to pay corporate tax in FY19. Despite the higher revenue contribution from F&B Malaysia, F&B Thailand commands a higher contribution to operating profit of 60.7% (vs FY17: 65.4%). Nonetheless, earnings growth has moderated in FY18 due to the: (i) challenging F&B market condition in Thailand and; (ii) temporary loss of UHT milk revenue caused by product shortage attributed by a co-manufacturer's plant that was damaged by fire. Going forward, we expect lower contribution from F&B Thailand given that it will be subjected to corporate tax rate of 20.0% following the full utilisation of promotional incentive and carried forward losses from non-promoted businesses in Thailand.

Impact to earnings forecast. We revised our earnings forecasts for 2019 downward by -8.7% to take into consideration: (i) the increase in tax expense for F&B Thailand segment going forward and; (ii) higher purchase price of soft drinks which is expected to negatively affect demand.

Target Price. Therefore, we revised our target price downward to **RM31.54** (previously RM34.52) per share which is based on FY19F EPS of 121.3sen pegging to a target PER of 26.0x which is its five-year historical average.

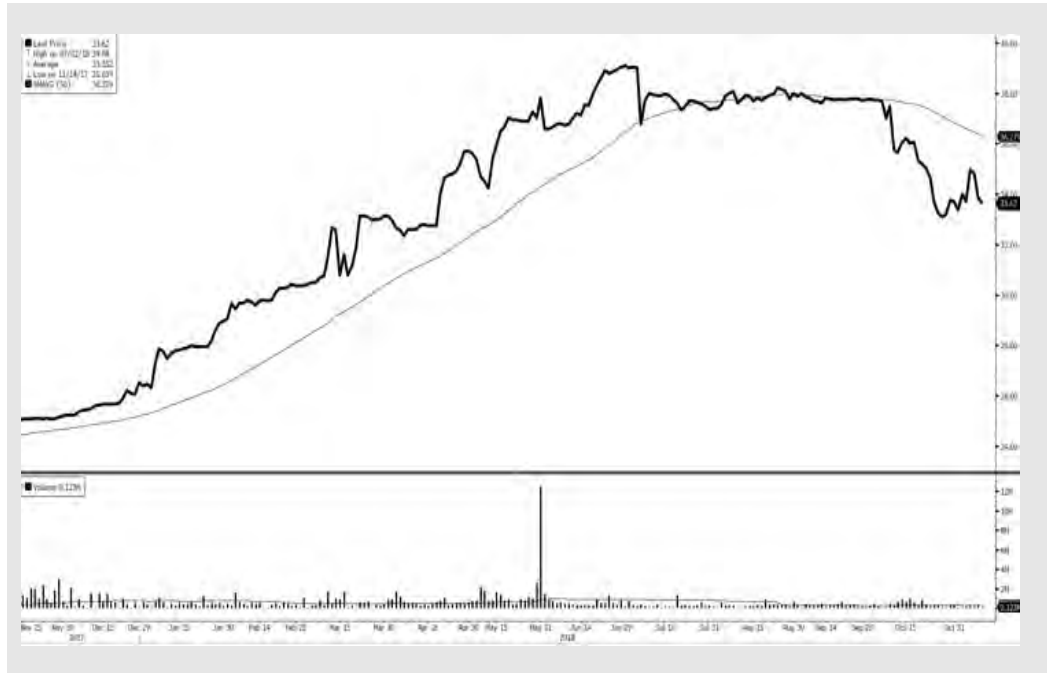
Maintain NEUTRAL. While we expect weaker earnings contribution from Thailand in view of higher tax expense, we believe that the group's earnings growth will continue to grow, albeit moderated pace, driven by the: (i) improved cost efficiency as a result of cost optimisation efforts; and (ii) continued strong export growth. In addition, we expect that the recent imposition of excise duty at RM0.40 per litre on ready-to-drink beverages that contain sugar exceeding 5.0g per 100ml, starting 1 April 2019, will have a minimal impact on F&N's bottom line due to the: (i) lower overall contribution of soft drink segment to the group's earnings. All things considered, we maintain our **NEUTRAL** call on the stock. 

INVESTMENT STATISTICS

FYE Sep (RMm)	FY2017	FY2018	FY2019F	FY2020F
Revenue	4,101.4	4,109.9	4,256.4	4,426.5
Gross profit	1,368.5	1,382.2	1,489.7	1,571.4
Operating profit	345.1	420.2	512.7	554.6
PBT	353.7	422.7	521.0	563.2
Tax expense	(30.4)	(37.6)	(76.2)	(86.6)
PAT	323.3	385.1	444.8	476.6
One-off items	52.7	(3.2)	0.0	0.0
Normalised PAT	376.1	381.9	444.8	476.6
Normalised EPS (sen)	102.5	104.1	121.3	129.9
Net Dividend (sen)	57.5	57.5	72.5	77.5
Operating profit margin (%)	8.4	10.2	12.0	12.5
Normalised PAT margin (%)	9.2	9.3	10.5	10.8
Effective Tax Rate (%)	8.6	8.9	14.6	15.4
EPS Growth (%)	(2.6)	1.5	16.5	7.1
Dividend yield (%)	1.7	1.7	2.2	2.3
PER (x)	32.8	32.3	27.7	25.9

Source: Company, MIDFR

DAILY PRICE CHART



Nabil Zainoodin, CFA, CA
nabil.zainoodin@midf.com.my
03-2772 1663

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS

BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to <i>rise</i> by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <10% over the next 12 months.
TRADING SELL	Stock price is expected to <i>fall</i> by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.

SECTOR RECOMMENDATIONS

POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.