

07 May 2018 | Briefing Note

Fraser & Neave Holdings Berhad

Future earnings growth may be dragged by higher costs

Downgrade to SELL

(Previously NEUTRAL)

Revised Target Price (TP): RM28.29

(Previously RM30.03)

INVESTMENT HIGHLIGHTS

- **2QFY18 normalised earnings lower by -17.2%yoy to RM88.7m, lagging ours and consensus expectations**
- **The group's total revenue growth was dragged mainly by the subdued performance from its Thailand's operation**
- **Rising input and packaging material costs to keep gross profit margin at bay**
- **Downgrade to a SELL with a lower TP of RM28.29**

Earnings lagged expectations. To recall, Fraser & Neave Holdings Bhd's (F&N) reported earnings for 2QFY18 came in lower by -13.6%yoy to RM92.6m. After adjusting for one-off items, the normalised earnings were down by -17.2%yoy to RM88.7m. This accounted for 44.8% and 46.6% of ours and consensus full year FY18 earnings forecasts respectively. In the last five financial years, the group first half of the year result on average accounted for 60% of full year earnings.

Marginal revenue growth recorded. F&N recorded a rather marginal revenue growth for the 2QFY18 of +2.2%yoy to RM1.0b. Despite the commendable growth of Malaysian operation of +7.0%yoy in the 2QFY18 driven by Chinese New Year (CNY) celebration, the strong growth was impacted by the subdued performance of the Thailand's operation which recorded a negative growth of -3.6%yoy. The weak performance of Thailand's operation was due to: (i) soft local market as the country's economic growth seen slowing down in 2018; and (ii) strengthening of MYR against THB by approximately +3.6%yoy which reduced the foreign currency translation gain.

Rising input and packaging costs eroded profit margin. In addition to the lower contribution from Thailand's operation, F&N also experienced rising input costs especially in milk-based commodity and packaging material costs compounded by the continuing uptrend in oil price. We expect that the prices of milk-based commodities and packaging material costs will continue to rise. For instance, skimmed milk powder has increased by +17.6%ytd to USD\$2,000 per metric tonne. Meanwhile, advertising and promotional expenses is estimated to be higher in FY18 to spur consumer spending during Ramadhan and Hari Raya season in Malaysia.


RETURN STATS

Price (4 th May 2018)	RM34.94
Target Price	RM28.29
Expected Share Price Return	-19.0%
Expected Dividend Yield	+2.1%
Expected Total Return	-16.9%

STOCK INFO

KLCI	1,841.83
Bursa / Bloomberg	3689 / FNH MK
Board / Sector	Main / Consumer
Syariah Compliant	Yes
Issued shares	366.54m
Market cap. (RM'm)	12,806.96m
Price over NA (x)	5.74
52-wk price Range	RM23.4 - RM36.7
Beta (against KLCI)	0.58
3-mth Avg Daily Vol	0.56m
3-mth Avg Daily Value (RM'm)	18.5m
Major Shareholders (%)	
Fraser and Neave Ltd	55.51
PNB & Associated funds	12.14
EPF	11.46

Impact to earnings forecasts. We revised our earnings forecasts for 2018 and 2019 downward by -9.1% and -7.1% respectively due to: (i) slower-than-expected recovery of the Malaysian operation; and (ii) lower-than-expected contribution to operating profit from Thailand's operation.

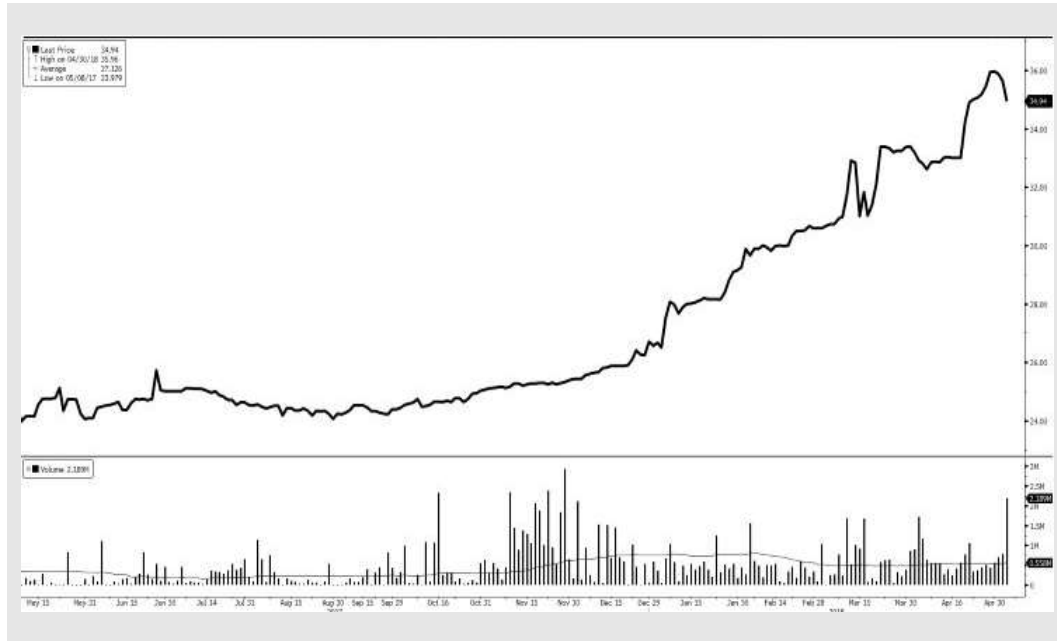
Downgrade to SELL. F&N's share price has rallied approximately +30.9%ytd. We believe that this was mainly attributable to optimistic investors' sentiment on consumer staples companies at the time of uncertainties. Due to the recent price rally, current PER is now at 44.4x while dividend yield has dropped to about 2.1%. At the current trading price, the stock is overvalued in comparison to the industry average PER and two-year historical PER of 30.8x and 26.7x respectively. In addition, we believe that forward earnings growth to taper down mainly due to higher operational costs. All factors considered, we are downgrading our recommendation to **SELL** (previously NEUTRAL) with a lower target price of **RM28.29 per share**. Our valuation is based on FY19F EPS of 132.8sen pegging it to a target PER of 21.3x which is -1.0SD below the two-year historical average. 

INVESTMENT STATISTICS

FYE Sep (RMm)	FY2015	FY2016	FY2017	FY2018F	FY2019F
Revenue	4,107.6	4,167.6	4,101.4	4,229.6	4,380.3
Cost of sales	(2,802.5)	(2,683.6)	(2,732.9)	(2,791.5)	(2,847.2)
Gross profit	1,305.1	1,484.0	1,368.5	1,438.1	1,533.1
Operating profit	332.0	433.4	345.1	441.1	532.7
PBT	333.8	442.9	353.7	449.4	541.2
PAT	280.1	385.4	323.3	404.4	487.1
One-off items	0.0	0.0	52.7	0.0	0.0
Normalised PAT	280.1	385.4	376.1	404.4	487.1
Normalised EPS (sen)	76.5	105.3	88.2	110.3	132.8
Net Dividend (sen)	57.5	57.5	57.5	60.0	72.5
Gross profit margin (%)	31.8	35.6	33.4	34.0	35.0
Operating profit margin (%)	8.1	10.4	8.4	10.4	12.2
PAT margin (%)	6.8	9.2	7.9	9.6	11.1
Normalised PAT margin (%)	6.8	9.2	9.2	9.6	11.1
EPS Growth (%)	7.7	37.6	(16.3)	25.1	20.4
Dividend yield (%)	1.6	1.6	1.6	1.7	2.1
PER (x)	45.7	33.2	39.6	31.7	26.3

Source: Company, MIDFR

DAILY PRICE CHART



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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.