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|---|-----------------|--|--------|
| Name of PLC: <i>Malayan Flour Mills Berhad (MFM)</i> | | PLC Website: www.mfm.com.my | |
| Business Summary: <i>Milling of wheat flour, trading in grains, manufacture of animal feeds and poultry products</i> | | | |
| Top Three Shareholders: <i>Teh Wee Chye and family</i> | | 24.2% | |
| <i>Tan Sri Dato' Seri Utama Arshad bin Ayub</i> | | 7.4% | |
| <i>Yong Kok Yian</i> | | 6.1% | |
| Market / Sector: | <i>Consumer</i> | Stock Code: | 3662 |
| | | Bloomberg Ticker: | MFL:MK |
| Market Capitalisation: | RM 671.4m | Recommendation: | BUY |
| Target Price: | RM 2.03 | Expected Capital Gain: | 66.4% |
| Current Price: | RM 1.22 | Expected Div Yield: | 5.3% |
| | | Expected Total Return: | 71.7% |
| Analyst: <i>Lim Boon Ngee</i> Tel: +603 2163 3200; Email: bnlim@bcta.com.my | | | |

| Key Stock Statistics | 2016 | 2017 | 2018F | 2019F |
|---------------------------------|-------|-------|-------------|-------|
| EPS (sen) | 14.7 | 12.5 | 9.8 | 13.5 |
| P/E (x) | 8.3 | 9.8 | 12.5 | 9.0 |
| Net Dividend/Share (sen) | 6.5 | 6.5 | 6.5 | 6.5 |
| NTA/Share (RM) | 1.51 | 1.51 | 1.55 | 1.62 |
| Book Value/Share (RM) | 1.51 | 1.52 | 1.55 | 1.62 |
| Issued Capital (mil shares) | 550.2 | 550.3 | 550.3 | 550.3 |
| 52-weeks Share Price Range (RM) | | | 1.22 - 2.41 | |
| Estimated free float | | | | 45% |
| Average volume (shares) | | | 442,520 | |

| Per Share Data | 2016 | 2017 | 2018F | 2019F |
|--------------------------|------|------|-------|-------|
| Year-end 31 Dec | | | | |
| Book Value/Share (RM) | 1.51 | 1.52 | 1.55 | 1.62 |
| Operating CF/Share (sen) | 7.7 | 21.6 | 22.9 | 17.5 |
| EPS (sen) | 14.7 | 12.5 | 9.8 | 13.5 |
| Net Dividend/Share (sen) | 6.5 | 6.5 | 6.5 | 6.5 |
| P/E (x) | 8.3 | 9.8 | 12.5 | 9.0 |
| P/Cash Flow (x) | 15.8 | 5.6 | 5.3 | 7.0 |
| P/Book Value (x) | 0.8 | 0.8 | 0.8 | 0.8 |
| Dividend Yield (%) | 5.3 | 5.3 | 5.3 | 5.3 |
| Payout Ratio (%) | 44.2 | 52.2 | 66.4 | 48.1 |
| ROE (%) | 10.1 | 8.2 | 6.4 | 8.5 |
| Net Gearing (%) | 74.3 | 84.1 | 112.8 | 112.3 |

| P&L Analysis (RM mil) | 2016 | 2017 | 2018F | 2019F |
|-----------------------|----------|----------|----------|----------|
| Revenue | 2,538.69 | 2,402.28 | 2,378.49 | 2,534.58 |
| EBITDA | 162.81 | 154.03 | 148.41 | 180.86 |
| Depreciation & amort | (47.70) | (53.38) | (67.92) | (69.87) |
| Net interest income | (10.52) | (11.90) | (19.13) | (22.98) |
| JV & associates | 6.73 | 7.74 | 9.52 | 9.80 |
| Pre-tax Profit | 111.32 | 96.49 | 70.88 | 97.80 |
| Net Profit | 80.84 | 68.57 | 53.87 | 74.33 |
| EBITDA Margin (%) | 6.4 | 6.4 | 6.2 | 7.1 |
| Pre-tax Margin (%) | 4.4 | 4.0 | 3.0 | 3.9 |
| Net-Margin (%) | 3.2 | 2.9 | 2.3 | 2.9 |

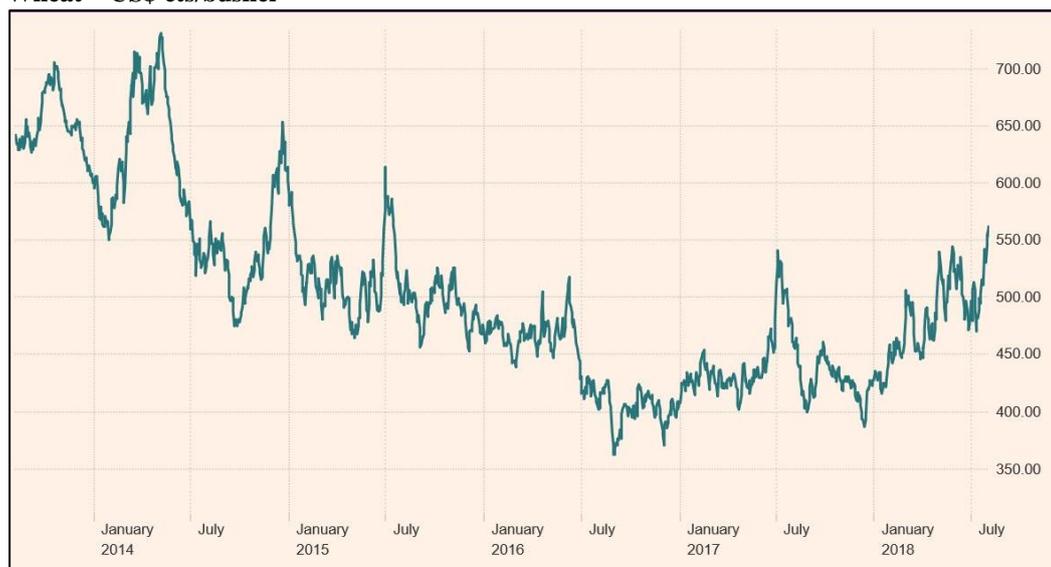
1. Investment Highlights/Summary

- The near-term prospects for flour milling business in Malaysia will remain challenging due to the increase in wheat cost and MFM's decision to delay the increase in flour price to maintain its market share. To mitigate the impact of higher wheat cost and improve profitability, MFM is looking into sourcing of wheat from other producing countries and restructuring of customer mix.
- Its poultry integration division has suffered from production performance issues since 4QFY17. There has been signs of improvement in day-old-chick production after MFM initiated action plans since end-FY17. The expansion of poultry processing plant, the new aqua feed mill and Lumut jetty expansion will be part-financed by a proposed Rights issue of RCULS and Rights, together with Bonus and free Warrants.
- We have reduced our earnings forecast by 13% and 6% for FY18 and FY19 to account for the rising wheat cost, reduced profitability of flour milling division and normalisation of production performance of poultry division. We think that the current hiccup is transitional and short-term in nature, and it does not change the long-term dynamics of MFM's integrated set-up and competitive position in the upstream food supply chain.
- Maintain Buy with a reduced target price of RM2.03 upon ascribing an unchanged P/E of 15x on our EPS forecast of 13.5 sen for FY19, below its book value of RM1.52.

2. Corporate Development

- We attended a briefing by MFM recently.
- The near-term prospects for **flour milling business in Malaysia** will remain challenging. Currently, the industry players including MFM's flour-milling operations in Lumut and Pasir Gudang are operating at an average utilisation rate of 50-60%. MFM's combined flour milling capacity of 2,000 mt of wheat/day is the second largest manufacturer in Malaysia. Overall, the industry is operating at excess capacity which has led to limited pricing flexibility. In addition, wheat cost has been on rising trend, reaching US\$5.50/bushel in Jul-18 from US\$4.00-4.50 in Jan-18.

Wheat – US\$ cts/bushel



- Its **flour milling operation in Vietnam** has a total production capacity of 2,700mt of wheat/day. It is currently the no 1 player in Vietnam, supplying mainly to food manufacturing companies. Both plants in Vietnam are operating at a combined utilization rate of 80%. With no new capacity coming on stream, it will be driven by organic growth, growing population base and increasing flour consumption/capita.
- As a whole, its flour and grains trading division recorded an EBIT of RM63.61m on a turnover of RM1,640.93m in FY17. However, its EBIT declined sharply by 73.9% to RM5.86m in 1QFY18 due to the increase in wheat cost and MFM's decision to delay the increase in flour price to maintain its market share. To mitigate the impact of higher wheat cost and improve its profitability, MFM is looking into sourcing of wheat from other producing countries and restructuring of its customer mix.
- Its 30%-owned **flour milling operation in Indonesia** is facing a decline in profit margins due to IDR depreciation and price competition. Since the commencement of production in FY13, it is now the 5th largest player with a capacity of 1,500 mt/day in Indonesia. As it is currently running at full capacity, there are plans to add new silo and additional lines to increase the capacity. Pricing competition was brought on by the largest player, PT Indofood Sukses Makmur Tbk, Bogasari to defend its market share against entrant of new players. It recorded a net profit of RM7.77m in FY17 and a net loss of RM1.52m in 1QFY18.
- The major drag to group profit performance has been its **poultry integration division**, which suffered from production performance issues since 4QFY17. This division had an issue with feed quality arising from import shipment from the US. This has subsequently been identified as the cause for mycotoxin contamination in its feed input. In 1QFY18, while turnover declined by 21.5% to RM157.79m, EBIT came in at only RM1.55m as compared with RM13.38m in 1QFY17. Its 1QFY18's profit performance was also hit by net fair value loss on biological assets amounting to RM4.99m in 1QFY18. Operationally, its poultry division would have recorded an EBIT of RM6.54m in 1QFY18.

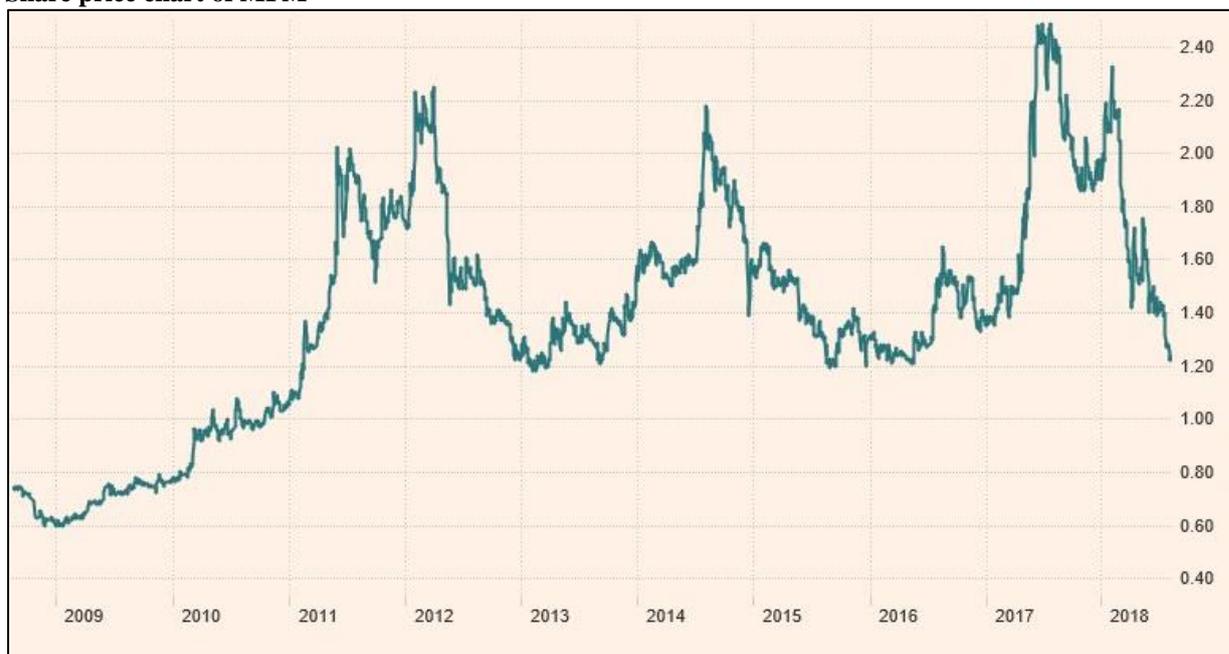
Additional measures such as better segregation of raw materials, installation of sensors for temperature monitoring and cooling system have been implemented to resolve the production issues, which should see better operating performance in 2HFY18. As the breeder flock has a long-life cycle period of approximately 16 months, it takes a few months for the farm to recover its performance. There has been signs of improvement in day-old-chick production after MFM initiated action plans since end-FY17.

- By increasing the cycle time, MFM has managed to increase the production capacity of **poultry processing plant** to 90,000 birds/day from 80,000 birds/day. The expansion of the poultry processing plant with a total budget of RM550m will triple the capacity to 240,000 birds/day. The construction of wastewater treatment and rendering plant under phase 1 is completed. Phase 2 involving primary processing will be completed in 1QFY19 with secondary processing under phase 3 to be completed in 2QFY20.
- MFM will be building a new and dedicated **aqua feed mill** at Lumut at an investment of RM65m. Upon completion, it will have a capacity of 10,000 mt/mth as compared with the current production of <2,000 mt/mth (through sharing the production capacity of poultry feed). The new aqua feed mill is expected to commence its commercial production towards latter part of FY18.
- The expansion of poultry processing plant, the new aqua feed mill and Lumut jetty expansion will be part-financed by a proposed Rights issue of RCULS and Rights, together with Bonus and free Warrants. The proposed exercise would raise a gross proceed amounting to RM220.0m (under minimum subscription basis) and RM275.14m (maximum subscription basis).

The immediate dilutive impact is manageable at around 11% pertaining to the completion of the Rights issue. The full dilutive impact of around 25% will only come in upon the full conversion of RCULS and Warrants, which both will have a 5-year tenure. Both the RCULS and Warrants can be converted and exercised on any market day within 5 years from the issue date. The proposal is expected to be completed by 4QFY18.

3. Valuation and Recommendation

- We have reduced our earnings forecast by 13% and 6% for FY18 and FY19 to account for the rising wheat cost, reduced profitability of flour milling division and normalisation of production performance of poultry division.
- We think that the current operational hiccup is transitional and short-term in nature, and it does not change the long-term dynamics of MFM's integrated set-up and competitive position in the upstream food supply chain.
- Maintain Buy with a reduced target price of RM2.03 upon ascribing an unchanged P/E of 15x on our EPS forecast of 13.5 sen for FY19. Due to the retracement in its share price, it is also currently trading below its book value of RM1.52.

Share price chart of MFM

Disclosures/Disclaimer

Investment ratings:

Buy (generally >10% upside over the next 12 months)

Hold (generally negative 10% downside to positive 10% upside over the next 12 months)

Sell (generally >10% downside over the next 12 months)

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