

Name of PLC: Malayan Flour Mills Berhad (MFM)		PLC Website: www.mfm.com.my	
Business Summary: Milling of wheat flour, trading in grains, manufacture of animal feeds and poultry products			
Top Three Shareholders: Teh Wee Chye and family		24.2%	
Tan Sri Dato' Seri Utama Arshad bin Ayub		7.4%	
Yong Kok Yian		6.1%	
Market / Sector:	Consumer	Stock Code:	3662
		Bloomberg Ticker:	MFL:MK
Market Capitalisation:	RM 836.4m	Recommendation:	BUY
Target Price:	RM 2.15	Expected Capital Gain:	41.4%
Current Price:	RM 1.52	Expected Div Yield:	4.3%
		Expected Total Return:	45.7%
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Key Stock Statistics	2016	2017	2018F	2019F
EPS (sen)	14.7	12.5	11.2	14.3
P/E (x)	10.3	12.2	13.5	10.6
Net Dividend/Share (sen)	6.5	6.5	6.5	6.5
NTA/Share (RM)	1.51	1.51	1.56	1.64
Book Value/Share (RM)	1.51	1.52	1.56	1.64
Issued Capital (mil shares)	550.2	550.3	550.3	550.3
52-weeks Share Price Range (RM)			1.42 - 2.50	
Estimated free float				44%
Average volume (shares)				281,050

Per Share Data	2016	2017	2018F	2019F
Year-end 31 Dec				
Book Value/Share (RM)	1.51	1.52	1.56	1.64
Operating CF/Share (sen)	7.7	21.6	18.2	15.0
EPS (sen)	14.7	12.5	11.2	14.3
Net Dividend/Share (sen)	6.5	6.5	6.5	6.5
P/E (x)	10.3	12.2	13.5	10.6
P/Cash Flow (x)	19.7	7.0	8.4	10.2
P/Book Value (x)	1.0	1.0	1.0	0.9
Dividend Yield (%)	4.3	4.3	4.3	4.3
Payout Ratio (%)	44.2	52.2	57.8	45.3
ROE (%)	10.1	8.2	7.3	8.9
Net Gearing (%)	74.3	84.1	114.7	115.1

P&L Analysis (RM mil)	2016	2017	2018F	2019F
Revenue	2,538.69	2,402.28	2,510.02	2,749.07
EBITDA	162.81	154.03	165.30	195.58
Depreciation & amort	(47.70)	(53.38)	(67.92)	(69.87)
Net interest income	(10.52)	(11.90)	(19.71)	(24.36)
JV & associates	6.73	7.74	9.52	9.80
Pre-tax Profit	111.32	96.49	87.19	111.15
Net Profit	80.84	68.57	61.90	78.91
EBITDA Margin (%)	6.4	6.4	6.6	7.1
Pre-tax Margin (%)	4.4	4.0	3.5	4.0
Net-Margin (%)	3.2	2.9	2.5	2.9

1. 1QFY18 Results Highlight

	1Q FY18	1Q FY17	Chg
	RMm	RMm	%
Revenue	563.82	604.18	(6.7)
Operating Profit	7.45	35.75	(79.2)
Net finance cost	(3.47)	(2.28)	52.3
JV & Associates	(1.53)	0.33	(568.7)
Pre-tax Profit	2.45	33.80	(92.8)
Net Profit	1.60	24.91	(93.6)
Operating Margin (%)	1.3	5.9	
Pre-tax Margin (%)	0.4	5.6	
Net-Margin (%)	0.3	4.1	

- In 1QFY18, group turnover declined by 6.7% to RM563.82m mainly due to lower contribution from the poultry integration division.
- Both PBT and net profit reported a more substantial drop to RM2.45m and RM1.60m respectively in 1QFY18, pulled lower by both core divisions of flour milling and poultry integration.
- In addition, its 30%-owned JV, PT Bungasari Flour Mills Indonesia (PTBFMI) reported a net loss of RM1.52m (1QFY18) as compared with net profit of RM0.33m (1QFY17). The net loss was attributed to the weaker IDR against US\$, despite the plant operating at full capacity.

- By segmental, its flour and grains trading division maintained its turnover at RM406.03m. However, segment EBIT declined by 73.9% to RM5.86m in 1QFY18. The lower profitability was attributed to higher wheat cost, where wheat prices have moved back up to US\$4.50-5.00/bushel (bu) from around US\$4.00/bu in Dec-17. To maintain its market share and sales volume in the local market that is faced with excess capacity, MFM did not increase its selling price of its flour products. The higher wheat cost would be mitigated by the strength in Ringgit and diversified sourcing of wheat from new sourcing countries.
- Turnover of poultry integration division declined by 21.5% to RM157.79m in 1QFY18. Consequently, the EBIT dropped by 88.4% to RM1.55m. Besides the lower selling price of live birds, the main contributing factor was the carry over effect of production performance issues from the previous 4QFY17. As the breeder flock has long life cycle of approximately 16 months, it will take a few more months for the farm to recover its production performance. There has been signs of improvement in day-old-chick production after MFM initiated action plans since end-FY17. It expects the performance issue to normalize by Jun-18. In addition, it also incurred a net fair value loss on biological assets of RM4.99m (1QFY18) against a gain of RM2.66m (1QFY17) and RM2.57m (4QFY17). Excluding this item, EBIT would have declined by 39% to RM6.54m (1QFY18) as compared with RM10.72m (1QFY17). However, it represented a marked improvement from RM0.95m recorded in 4QFY17.

2. Earnings Outlook

- MFM is an integrated food and poultry producer with manufacturing operations in flour milling, grains trading, animal feeds, management of breeder and broiler farms and the downstream processing of poultry products.
- For its **flouring milling operations in Malaysia**, near term profitability has been impacted by higher wheat cost and the lack of flexibility to pass-on higher cost to customers. We expect this to be mitigated by successful restructuring of customers mix and shedding of certain non-profitable customers.
- Stronger growth will come from its **flour milling operations in Vietnam and Indonesia** due to the larger population base and rising flour consumption /capita. Indonesia and Vietnam's per-capita flour consumption of 29kg and 9kg is considerable lower as compared with 47kg for Malaysia, according to Rabobank. We expect steady profit growth from its flour milling operations in Vietnam and Indonesia as a result of sustainable consumption growth in these markets.
- By Jun-18, the production performance issues of **poultry integration division** should be resolved, and profit margins should improve thereafter.
- The construction of a **new state-of-the-art poultry processing plant** in Sitiawan, Perak is in progress. MFM has allocated capex of RM550m for this project to be spent over FY17-19, aimed at tripling its current processing capacity of 80,000 birds/day to 240,000 birds/day. The new expansion will cater for the organic growth of its existing customers especially the QSR customers, rising demand for poultry products as well as demand from overseas markets.
- For the **production of animal feed**, MFM will be building a new and dedicated aqua feed mill at Lumut at an investment of RM60m. It has 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). Demand for animal feed will be underpinned by the growing production within the aquaculture sector in Malaysia and demand for higher-end aqua feed for shrimp, seabass, grouper etc. The feed mill is expected to commence its commercial production towards the latter part of FY18.

3. Valuation and Recommendation

- Although the reported 1QFY18's net profit is lower than expected, we are keeping our earnings forecast for FY18 and FY19 on expectation of a much-improved performance in the remaining quarters in FY18.
- Since early-2018, its share price has retraced from RM2.20-2.30 to the current RM1.50 level, bringing down valuations to more attractive levels for a consumer stock with a proven operating history.

- Short-term profit performance will be adversely affected by higher wheat cost, production performance issue as well as higher depreciation charges, finance expenses and pre-operating expenses associated with the construction of new processing plants. The longer-term growth prospects are well anchored by the tripling in capacity of downstream poultry processing and a new aqua feed mill.
- We are maintaining our Buy recommendation on the stock. We value the stock at RM2.15 upon ascribing a P/E of 15x on our EPS forecast of 14.3 sen for FY19. Its share price is also currently at slightly above its book value of RM1.46.

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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