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|--|-----------|--|--------|
| 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 863.9m | Recommendation: | BUY |
| Target Price: | RM 2.15 | Expected Capital Gain: | 36.9% |
| Current Price: | RM 1.57 | Expected Div Yield: | 4.1% |
| | | Expected Total Return: | 41.1% |
| Analyst: Lim Boon Ngee Tel: +603 2163 3200; Email: bnlim@bcta.com.my | | | |

| Key Stock Statistics | 2016 | 2017 | 2018F | 2019F |
|---------------------------------|-------|-------|-------------|---------|
| EPS (sen) | 14.7 | 12.5 | 11.2 | 14.3 |
| P/E (x) | 10.7 | 12.6 | 14.0 | 10.9 |
| 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) | | | | 222,150 |

| 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) | 10.7 | 12.6 | 14.0 | 10.9 |
| P/Cash Flow (x) | 20.3 | 7.3 | 8.6 | 10.5 |
| P/Book Value (x) | 1.0 | 1.0 | 1.0 | 1.0 |
| Dividend Yield (%) | 4.1 | 4.1 | 4.1 | 4.1 |
| 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. Investment Highlights/Summary

- We like MFM for its sizeable flour milling operations where it is a leading player in Malaysia, Vietnam and Indonesia. MFM is uniquely positioned given its exposure to the fast-growing flour consumption demand in Vietnam and Indonesia.
- MFM has a fully integrated poultry business which combines a strong upstream advantage in sourcing feed grains, feed production, farming and hatchery, and downstream poultry processing under one roof. This has put MFM in a competitive position in terms of logistics, pricing and raw material quality.
- The longer-term growth prospects are well anchored by the tripling in capacity of downstream poultry processing and a new aqua feed mill.
- Since early-2018, its share price has retraced considerably from RM2.20-2.30 to the current RM1.50 level. The share price correction has brought down the valuation to an attractive level for a consumer stock with a proven operating history.
- We have upgraded our recommendation to a Buy (from a Hold) based on valuations. 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 RM1.52.

2. Corporate Development

- We recently met management for an update.

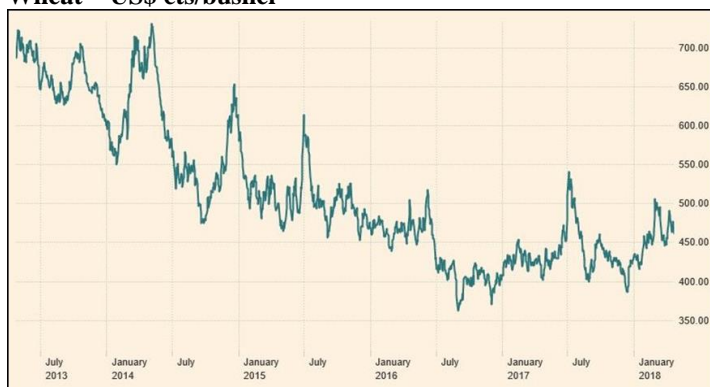
Segmental turnover and EBIT

| Turnover (RMm) | FY16 | FY17 | % chg |
|------------------------|-----------------|-----------------|--------------|
| Flour & grains trading | 1,735.38 | 1,640.93 | -5.4% |
| Poultry integration | 803.31 | 761.35 | -5.2% |
| Group turnover | 2,538.69 | 2,402.28 | -5.4% |

| EBIT (RMm) | FY16 | FY17 | % chg |
|------------------------|---------------|---------------|---------------|
| Flour & grains trading | 53.68 | 63.61 | 18.5% |
| Poultry integration | 61.45 | 37.10 | -39.6% |
| Others | (0.03) | (0.05) | |
| Group EBIT | 115.11 | 100.65 | -12.6% |

- In FY17, its flour and grains trading division experienced a 5.4% decline in turnover to RM1,640.9m. Its EBIT however improved 18.5% to RM63.61m in FY17. This division is involved in the milling of wheat flour and trading in grains.
- This decline in revenue was mainly due to lower contribution from **grains trading operation**, which is undertaken by its 51%-owned Premier Grain Sdn Bhd. Based on our estimate, this segment recorded a 14% decline in turnover to around RM460m in FY17. The lower sales volume of grains trading was attributed to stiffer competition in the local market caused by bumper harvest of global agricultural commodities in 2017. The excess supply led to aggressive marketing and pricing competition from traders. As a result, we believe grain trading operation suffered a loss in FY17. In FY18, commodity pricing has normalized. Coupled with management’s better timing of purchases, this operation should return to profitability.
- Its **flour milling operations** currently operate two flour mills each in Malaysia (with a capacity of 1,950 mt of wheat/day) and Vietnam (2,700 mt). MFM is one of the key producers in Malaysia with a market share of around 25%. It also operates a flour mill in Indonesia (1,500 mt) under a 30%-owned PT Bungasari Flour Mills Indonesia (PTBFMI).
- Its **flour milling operations in Malaysia** recorded a 4% decline in turnover to RM433m in FY17 as it has been focusing on working with profitable customers. It was operating on a lower utilization rate in FY17 due to excess capacity in the local industry. However, it recorded a sharp improvement in profit margins due to lower sales volumes to less profitable customers. Since Jan-18, wheat prices have moved back up to US\$4.50-5.00/bushel (bu) from around US\$4.00/bu in Dec-17. However, the higher wheat cost will be mitigated by the strength in Ringgit and diversified sourcing of wheat from new sourcing countries. Given the excess capacity in Malaysia, the potential increase in selling price will be constrained by competition. As a whole, turnover is expected to remain flattish to marginally higher. Profit margins is expected to be steady, driven by the successful restructuring of customers mix.

Wheat – US\$ cts/bushel



- In FY17, contribution from **flour milling operations in Vietnam** was flat at RM745m. Despite the increased market competition, MFM was able to defend its market share due to its strong and entrenched distribution network and long operating history in Vietnam. 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.
- Its **flour milling operation in Indonesia** under PTBFMI grew its turnover by 84% to RM995m in FY17. This was attributed to increased production run-rate and higher economies of scale. MFM's share of net profit (under jointly-controlled) improved to RM25.90m (FY17) as compared with RM21.36m (FY16). Profit would have been better if not for the depreciating Indonesian Rupiah against Ringgit. PTBFMI currently only commands a market share of 5% in Indonesia, which has a sizeable population and growing flour consumption. It's looking at expanding silos and evaluating options for capacity expansion.
- In FY17, while turnover of its **poultry integration division** experienced a 5.2% decline to RM761.4m, EBIT declined by 39.6% to RM37.10m. The business activities comprise the manufacturing of animal and aqua feeds; and production of poultry products.
- The main contributing factor to the lower margins was production performance issues and raw materials' quality. A sizeable portion of MFM's broiler production caters for quick service restaurants (QSR). To have a better control, only broilers produced by in-house farm house can be supplied to QSR segment. In FY17, there was a sudden surge in demand for broiler from QSR segment while MFM's supply is limited by capacity constraints of own farm houses. The increase in demand and production led to higher operating costs. In addition, the poorer profit performance of poultry integration division was also due to lower sales volume of poultry feed, lower gains derived from insurance recovery and revaluation of biological assets. Additional measures have been implemented to resolve the production issues, which should see better operating performance in FY18. In addition, MFM has plans to construct new farm houses in FY18.

- The construction of a **new state-of-the-art poultry processing plant** in Sitiawan, Perak is in progress. It has allocated a capex of RM550m for this project to be spent over FY17-19 to triple its current processing capacity of 80,000 birds/day to 240,000 birds/day. The project is divided into three phases.

Phase 1, which includes the construction of wastewater plant and poultry waste (by-products) rendering plant will be ready by Jun-18. This system not only prevents pollution to the environment, it also converts poultry waste into meat meal used for producing animal feed. This can be used as the input materials for MFM's planned construction of a new aqua feed plant. Phase 2 (primary processing) and phase 3 (further processing of chicken products) will be ready by 1QFY19 and 1QFY20 respectively.

The new expansion will cater for the organic growth of its existing customers especially the QSR operators and rising demand for poultry products. It also plans to export its processed poultry products to untapped overseas markets such as the Middle-East, China, Hong Kong and Europe. In addition, the enlarged capacity will allow the company to better serve its end-retail markets through more product varieties. Upon full production, MFM aims to have a more balanced contribution from flour and poultry divisions. In FY17, flour milling recorded a turnover of RM1,180m as compared with RM761m achieved by poultry integration division.

- 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). The demand is underpinned by the growing production of 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 latter part of FY18.
- In FY17, MFM incurred a capex of RM175m. The bulk of this (RM148m) was spent on poultry integration division for the construction of the new aqua feed mill, rendering plant and primary processing plant. Capex will remain high for FY18-19 for the completion of the RM550m new processing plant and expansion on Lumut jetty.

- As at end-FY17, MFM has a net debt position of RM702m. Net gearing stood at 0.84x. Based on our estimate, its net gearing ratio would hit 1.1x as at end-FY18. However, a closer examination of its debt profile shows that a substantial portion of its debt is in bankers' acceptances/revolving credit (amounting to RM864m), mainly for funding of wheat raw materials and grains trading.

Loans and borrowings

| RMm | FY17 |
|--|-----------------|
| Long-term unsecured term loans | (76.19) |
| Short-term unsecured term loans | (19.36) |
| Short-term bankers' acceptances/revolving credit | (863.76) |
| Cash | 257.77 |
| Net cash | (701.55) |
| Net gearing (x) | 0.84 |

3. Earnings Outlook

- With no addition of new capacity of **flouring milling operations**, profit growth will be determined by increased factory utilization and better economies of scale. Stronger growth will come from 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. The successful restructuring of customers' mix and shedding of less profitable customers will underpin profit performance of flour milling operation in Malaysia. Profit at flour milling operations in Vietnam and Indonesia will be steadily growing due to organic consumption growth.
- Grains trading** business should return to the black, as commodity pricing has normalized, coupled with management's better timing of purchases.
- Production performance issues of **poultry integration division** have been resolved. Consequently, this would translate into better profit margins. Longer-term, the capacity expansion of poultry processing and the new aqua feed mill will impact its financial performance positively from FY19 onwards. Meanwhile, MFM will be incurring higher depreciation and finance costs in FY18 due to the investment in new processing plants and higher borrowings.
- Profitability will remain challenging against the backdrop of rising raw material prices since early-FY18. The major cost items are wheat, corn and soybean meal, which form the raw materials for the production of flour and feed. However, the rising cost is mitigated by Ringgit appreciation and better sourcing of raw materials. Additionally, there is room for MFM to manage the rising cost pressure given that the selling price is non-regulated for flour and poultry products (except for general purpose flour in Malaysia and excess capacity in Malaysia).

4. Valuation and Recommendation

- Since early-2018, its share price has retraced considerably from RM2.20-2.30 to the current RM1.50 level. The share price correction has brought down the valuation to an attractive level for a consumer stock with a proven operating history.
- We like MFM for its sizeable flour milling operation, as one of the leading players in Malaysia, Vietnam and Indonesia. MFM is uniquely positioned given its exposure to the faster-growing flour consumption demand in Vietnam and Indonesia. MFM has a fully integrated poultry business which combines a strong upstream advantage in sourcing feed grains, feed production, farming and hatchery and downstream poultry processing under one roof. This has put MFM in a competitive position in terms of logistics, pricing and raw material quality.
- The longer-term growth prospects are well anchored by the tripling in capacity of downstream poultry processing and a new aqua feed mill.

- In FY18, MFM will have to incur higher depreciation charges, finance expenses and pre-operating expenses. In addition, profit margins will be affected by the rising costs of raw materials. As such, we have reduced our earnings forecast by 20% for FY18.
- We have introduced our earnings forecast for FY19, which has factored in additional contribution from the new aqua feed mill and primary processing plant. We have upgraded our recommendation to a Buy (from a Hold) based on valuations. 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 RM1.52.

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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