

HLIB Research

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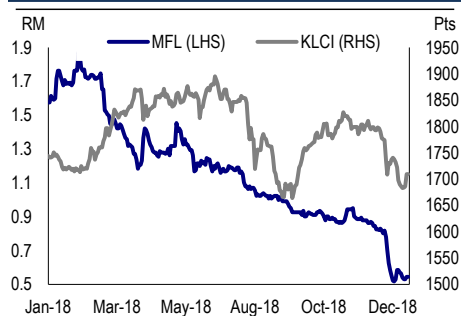
Target Price: **RM0.72**
Previously: -

Current Price: **RM0.495**

Capital upside	45.5%
Dividend yield	4.0%
Expected total return	49.5%

Sector coverage: Food Producer

Company description: MFM is involved in flour and grains trading as well as integrated poultry business.

Share price


Historical return (%)	1M	3M	12M
Absolute	-36.1	-43.5	-68.7
Relative	-34.9	-39.2	-66.4

Stock information

Bloomberg ticker	MFLMK
Bursa code	3662
Issued shares (m)	550
Market capitalisation (RM m)	272
3-mth average volume ('000)	470
SC Shariah compliant	Yes

Major shareholders

The Wee Chye	11.2%
Credit Suisse Group AG	8.7%
LiewPhairatana Duangmanee	6.0%

Earnings summary

FYE (Dec)	FY17	FY18f	FY19f
PATMI - core (RM m)	46.9	25.7	56.3
EPS - core (sen)	5.7	3.1	6.8
P/E (x)	8.7	15.9	7.3

Malayan Flour Mills

Better years ahead

We believe MFM's earnings will bottom in FY18 and recover to RM59.4m and RM62.0m in FY19-20, underpinned by (i) improved broiler production performance (as the issue has already been rectified since end-1H18), (ii) higher production capacity at downstream processing sub-segment, which carries better profitability vis-a-vis live birds, (iii) turnaround at 30%-owned JV as price competition has eased since 3Q18, and (iv) higher aqua feed sales volume. We derive a fair value of RM0.72 on MFM by using sum-of-parts valuation. We value MFM's (i) flour and grains segment at 12x FY19 core net profit, and (ii) poultry integration segment at 10x FY19 core net profit.

Company background. Malayan Flour Mills (MFM) is involved in 2 major businesses, namely (i) flour and grains trading businesses in Malaysia, Vietnam and Indonesia, and (ii) integrated poultry business in Malaysia.

Expanding integrated poultry segment footprint in Malaysia. MFM has been embarking on major expansion plan on its poultry integration segment with a total investment sum of at least RM550m since FY17. The expansion plan includes (i) capacity expansion at the broiler segment (pending approvals from relevant authorities), (ii) capacity expansion at the broiler processing segment (from 80,000 birds per day to 240,000 birds per day by mid-FY19), (iii) construction of by-product processing plant, (iii) construction of a new aqua feed milling plant, and (iv) extension of existing jetty and upgrade of ship unloaders in Lumut, Perak.

Fund raising exercise. MFM had on 19 Jul 2018 proposed a fund-raising exercise to raise up to RM275.1m via a combination of (i) rights issue of 5-year redeemable convertible unsecured loan stock (RCULS), and (ii) rights issue of shares.

Capacity expansion to lift and broaden earnings. The capacity expansion (which will be completed in stages) at the poultry integration segment will lift MFM's earnings over the next few years, on the back of higher capacity. Earnings growth prospects aside, we note the ongoing capacity expansion will also broaden MFM's earnings base (albeit gradually) within the poultry integration segment, hence easing earnings volatility, as higher production output at the processing sub-segment allows MFM to divert more broiler output into the processing sub-segment (i.e. processed and/or further processed products), which command higher profit margins and more stable prices.

Earnings recovery from FY19. We believe MFM's earnings will bottom in FY18 and recover to RM59.4m and RM62.0m in FY19-20, underpinned by (i) improved broiler production performance (as the issue has already been rectified since end-1H18), (ii) higher production capacity at downstream processing sub-segment, which carries better profitability vis-a-vis live birds, (iii) turnaround at 30%-owned JV as price competition has eased since 3Q18, and (iv) higher aqua feed sales volume.

Fair value of RM0.72. We derive a fair value of RM0.72 on MFM by using sum-of-parts valuation, i.e. (i) 12x FY19 core net profit for flour and grains segment, in line with MSM Malaysia's valuation multiple given the similarities shared between MFM and MSM, (ii) 10x FY19 core net profit for poultry integration segment, in line with the smaller sized integrated poultry players in Malaysia, and (iii) adding on proceeds from its fund-raising exercise.

Financial Forecast

All items in (RM m) unless otherwise stated

Balance Sheet

FYE Dec	FY16	FY17	FY18f	FY19f	FY20f
Cash	371.2	257.8	388.4	163.5	1.6
Receivables	471.9	373.1	484.1	534.3	581.3
Inventories	455.1	493.0	580.9	641.2	697.6
PPE	662.1	769.1	1,066.2	1,194.9	1,331.0
Others	127.7	134.8	137.9	150.8	163.3
Assets	2,088.1	2,027.8	2,657.5	2,684.9	2,774.7
Payables	172.2	147.2	193.6	213.7	232.5
Debt	990.3	959.3	1,319.3	1,264.3	1,264.3
Others	8.2	14.0	14.0	14.0	14.0
Liabilities	1,170.7	1,120.5	1,527.0	1,492.0	1,510.8
Shareholder's equity	833.1	834.6	1,102.3	1,158.6	1,223.7
Minority interest	84.3	72.6	77.6	83.6	89.6
Equity	917.4	907.3	1,180.0	1,242.3	1,313.4

Cash Flow Statement

FYE Dec	FY16	FY17	FY18f	FY19f	FY20f
Profit before taxation	111.3	96.5	42.4	79.0	90.8
D&A	47.7	53.4	56.4	66.9	74.6
Working capital	(96.0)	(13.1)	(161.0)	(97.8)	(91.5)
Taxation	(15.3)	(14.4)	(11.7)	(16.8)	(19.7)
Others	(5.5)	(3.4)	5.0	(6.0)	(6.0)
CFO	42.3	119.0	(68.9)	25.3	48.2
Capex	(74.6)	(172.6)	(353.0)	(195.0)	(210.0)
Others	(1.0)	(5.6)	(0.1)	(0.1)	(0.1)
CFI	(75.6)	(178.2)	(353.1)	(195.1)	(210.1)
Changes in debt	153.5	14.6	360.0	(55.0)	-
Shares issued	-	0.1	110.1	-	-
Dividends	(27.5)	(35.8)	-	-	-
Others	(2.9)	(6.9)	82.5	-	-
CFF	123.1	(27.9)	552.6	(55.0)	-
Net cash flow	89.8	(87.2)	130.6	(224.8)	(161.9)
Forex	7.8	(26.2)	-	-	-
Others	-	-	-	-	-
Beginning cash	273.7	371.2	257.8	388.4	163.5
Ending cash	371.2	257.8	388.4	163.5	1.6

Income Statement

FYE Dec	FY16	FY17	FY18f	FY19f	FY20f
Revenue	2,613.0	2,477.8	2,904.7	3,206.0	3,487.8
EBITDA	162.8	154.0	115.6	153.0	174.3
EBIT	115.1	100.7	59.7	86.8	100.4
Finance cost	(10.5)	(11.9)	(12.4)	(13.8)	(15.6)
Associates & JV	6.7	7.7	(5.0)	6.0	6.0
Profit before tax	111.3	96.5	42.4	79.0	90.8
Tax	(18.4)	(24.5)	(11.7)	(16.8)	(19.7)
Net profit	93.0	72.0	30.7	62.3	71.1
Minority interest	(12.1)	(3.4)	(5.0)	(6.0)	(6.0)
Reported PATMI	80.8	68.6	25.7	56.3	65.1
Exceptionals	(7.3)	(21.7)	-	-	-
Core PATMI	73.6	46.9	25.7	56.3	65.1
Consensus core PATMI	-	-	-	-	-
HLIB/ Consensus	-	-	-	-	-

Valuation & Ratios

FYE Dec	FY16	FY17	FY18f	FY19f	FY20f
Core EPS (sen)	8.9	5.7	3.1	6.8	7.9
Core FD EPS (sen)	6.1	3.9	2.1	4.6	5.4
P/E (x)	5.6	8.7	15.9	7.3	6.3
P/E - fully-diluted (x)	8.1	12.8	23.3	10.6	9.2
DPS (sen)	6.5	6.5	4.0	2.0	2.0
Dividend yield	13.1	13.1	8.1	4.0	4.0
BVPS (RM)	1.0	1.0	1.3	1.4	1.5
P/B (x)	0.5	0.5	0.4	0.4	0.3
EBITDA margin	6.2%	6.2%	4.0%	4.8%	5.0%
EBIT margin	4.4%	4.1%	2.1%	2.7%	2.9%
PBT margin	4.3%	3.9%	1.5%	2.5%	2.6%
Net margin	2.8%	1.9%	0.9%	1.8%	1.9%
ROE	9.2%	5.6%	2.7%	5.0%	5.5%
ROA	3.7%	2.3%	1.1%	2.1%	2.4%
Net gearing	74.3%	84.1%	84.5%	95.0%	103.2%

Assumptions

FYE Dec	FY18f	FY19f	FY20f
USD/ringgit	4.20	4.20	4.20
VND/ringgit	5,700	5,700	5,700

Flour milling

Production vol ('000 tonnes)	882.9	904.0	928.4
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Broiler operations

Production vol (m birds)	51.5	60.3	69.1
Average selling price (RM/kg)	4.60	4.70	4.70

Company Background

History. The history of Malaysian Flour Mills Bhd (MFM) traces back to 1966 when the late Datuk David Sung (the founder, whose ancestor founded China's first machine operated flour mill in Shanghai in 1890), built a flour mill in Lumut, Perak. In 1976, the late Mr Teh Liang Teik acquired the controlling interests in MFM from the Sung family as he saw the potential of MFM. Since then, MFM has evolved from a pure flour miller in Malaysia to an integrated food and poultry producer, with 2 major business segments across Malaysia, Vietnam and Indonesia, namely (i) flour and grains trading segment, and (ii) integrated poultry segment.

Flour and grains trading. MFM has flour milling operations in Malaysia and Vietnam, with total milling capacity of 4,650 mt of wheat per day (see Figure #2 for geographical segmental breakdown). Besides, MFM has a 30% stake in PT Bungasari Flour Mills, which has milling capacity of 1,500mt of wheat per day. Flour milling operations aside, MFM has a procurement and trading arm (through 51%-owned Premier Grain Sdn Bhd, a JV between MFM and Toyota Ysusho Corporation), which sources grain commodity ranging from corn, soybean to soybean meal (the major ingredients of animal feed production). In FY17, flour and grains trading segment accounted for 68% and 63% of MFM's revenue and operating profit, respectively.

Figure #1 MFM's milling capacity

	mt of wheat/day
Malaysia	
Lumut, Perak	1,100
Pasir Gudang, Johor	850
Vietnam	
Hanoi (through 70%-owned Vimaflour)	1,500
Ho Chi Minh (through 100%-owned Mekong Flour Mills)	1,200
Total	4,650
Jakarta, Indonesia (through 30%-owned PT Bungasari Flour Mills)	1,500

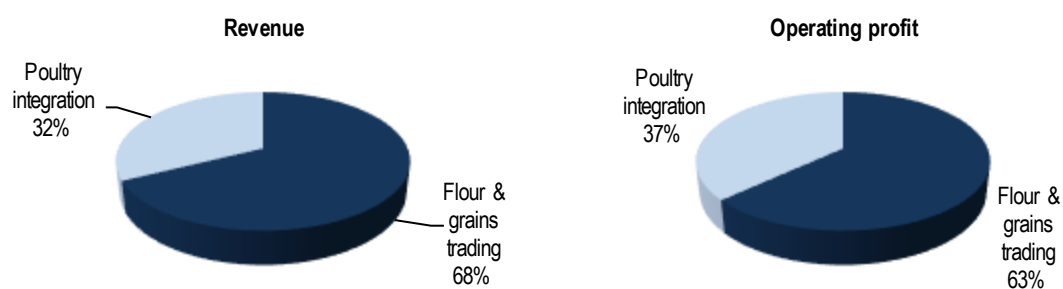
MFM; HLIB Research

Integrated poultry. MFM's integrated poultry segment can be broken down into 2 sub-segments, i.e. (i) manufacture and sale of animal and aqua feeds, and (ii) processing and sale of poultry products, poultry grow-out farm, breeding and sale of day-old-chicks and contract farming activities in Malaysia. In FY17, integrated poultry segment accounted for 32% and 37% of MFM's revenue and operating profit, respectively.

Figure #2 Snapshot of MFM's integrated poultry segment



MFM

Figure #3 Segmental revenue and operating profit in FY17

MFM; HLIB Research

Expanding integrated poultry segment footprint in Malaysia. In line with its vision to become an integrated food producer in the country, MFM has been embarking on major expansion plan on its poultry integration segment with a total investment sum of at least RM550m since FY17. The expansion plan (which started in FY17 and targeted to complete in stages by FY20) includes (i) capacity expansion at the broiler segment (pending approvals from relevant authorities), (ii) capacity expansion at the broiler processing segment (from 80,000 birds per day to 240,000 birds per day by mid-FY19), (iii) construction of by-product processing plant (which will then be used as part of formulation in producing poultry and aqua feeds), (iii) construction of a new aqua feed milling plant, and (iv) extension of existing jetty and upgrade of ship unloaders in Lumut, Perak.

MFM's fund raising exercise. MFM had on 19 Jul 2018 proposed a fund raising exercise to raise up to RM275.1m via a combination of:

- Rights issue of 5-year redeemable convertible unsecured loan stock (RCULS)** – which entails the issuance of up to RM165.1m (at 100% of its nominal value of RM1) on the basis of 3 RCULS for every 10 existing MFM shares, together with up to (i) 82.5m bonus shares on the basis of 1 bonus share for every 2 RCULS subscribed, and (ii) 82.5m free warrants on the basis 1 free warrant for every RCULS subscribed, and
- Rights issue of shares** – which entails the issuance of up to RM110m, of which the entitlement basis will be determined later. For illustrative purpose, the proposed rights issue may entail an issuance of up to 366.9m rights shares and the assumed entitlement basis of 2 rights shares for every 3 existing MFM shares at an illustrative issue price of 30 sen per rights share, together with up to (i) 61.1m bonus shares on the assumed basis of 1 bonus shares every 6 rights shares subscribed and (ii) up to 73.4m free warrants 1 free warrant for every 5 rights shares subscribed.

Proposed use of proceeds from fund raising exercise. Depending on the level of acceptance, MFM plans to utilise (i) 78.8-87.6% of the gross proceeds for capex and capex-related activities, (ii) 10.8-19.9% for repayment of revolving credit loans, and (iii) the remaining 1.3-1.6% as estimated expenses related to fund raising exercise (see Figure #6).

Figure #4 Pro forma effects of the proposals on MFM's total share capital

	Minimum Scenario		Maximum Scenario	
	'000 shares	RM'000	'000 shares	RM'000
Existing share capital	550,285	377,501	550,285	377,501
To be issued for the rights shares ^A	293,333	88,000	366,857	110,057
To be issued for the bonus shares arising from rights issue of RCULS	66,000	0	82,543	0
To be issued for the bonus shares arising from rights issue of shares	48,889	0	61,143	0
To be issued assuming full conversion of RCULS	440,000	132,000	550,285	165,086
To be issued full exercise of free warrants from rights issue of RCULS	66,000	35,640	82,543	44,573
To be issued full exercise of free warrants from rights issue of shares	58,667	31,680	73,371	39,620
Exlarged total issued & share capital	1,523,174	664,821	1,767,027	736,837

MFM; HLIB Research

Figure #5 Proposed use of proceeds from fund raising exercise

	Minimum Scenario RM'000	Maximum Scenario RM'000
Capital expenditure and repayment of revolving credit loans drawn to finance the capital expenditure	192,761	216,761
(i) Expansion of existing poultry processing plant in Sitiawan, Perak		
- Ongoing construction of an additional complex, reconstruction of existing poultry processing complex, ongoing construction of a rendering plant (by-product processing plant) and a waste water treatment plant	69,010	78,010
- Purchase and installation of new poultry processing equipment	72,990	81,990
(ii) Construction of a new aqua feed milling plant in Lumut, Perak		
- Ongoing construction of a new aqua feed milling plant which includes a raw material unloading station and a packing station	4,597	5,597
- Purchase and installation of new poultry processing equipment	2,968	2,968
(iii) Extension of existing jetty and upgrading of the ship unloaders in Lumut, Perak	43,196	48,196
Repayment of revolving credit loans drawn to finance working capital requirement	23,655	54,798
Estimated expenses for propose rights issue of RCULS and shares	3,584	3,584
Total	220,000	275,143

MFM; HLIB

Investment Thesis

Capacity expansion to drive earnings from FY19

Capacity expansion to lift and broaden earnings. The capacity expansion (which will be completed in stages) at the poultry integration segment will lift MFM's earnings over the next few years, on the back of higher capacity. Earnings growth prospects aside, we note the ongoing capacity expansion will also broaden MFM's earnings base (albeit gradually) within the poultry integration segment, hence easing earnings volatility, as higher production output at the processing sub-segment allows MFM to divert more broiler output into the processing sub-segment (i.e. processed and/or further processed products), which command higher profit margins and more stable prices.

Broader earnings base to ease earnings volatility. The ongoing capacity expansion will also broaden MFM's earnings base (albeit gradually) within the poultry integration segment, hence easing earnings volatility, as higher production output at the processing sub-segment allows MFM to divert more broiler output into the processing sub-segment (i.e. processed and/or further processed products), which command higher profit margins and more stable prices.

Figure #6 Poultry integration segment's historical earnings trend

	2013	2017	2022F	CAGR		% of total consumer food service in 2017
				2013 - 2017	2017 - 2022	
Consumer food service	31,345.9	38,367.3	55,401.9	5.2%	7.6%	100.0%
QSR	4,116.4	5,830.1	9,112.5	9.1%	9.3%	15.2%
FSR	11,653.6	13,606.3	18,800.6	4.0%	8.4%	35.4%
WHDTA	227.4	367.7	596.8	12.8%	10.2%	1.0%
Café/bars	7,822.1	9,187.8	12,633.2	4.1%	6.6%	23.9%
Others	7,526.5	9,375.3	14,258.8	5.6%	8.8%	24.4%

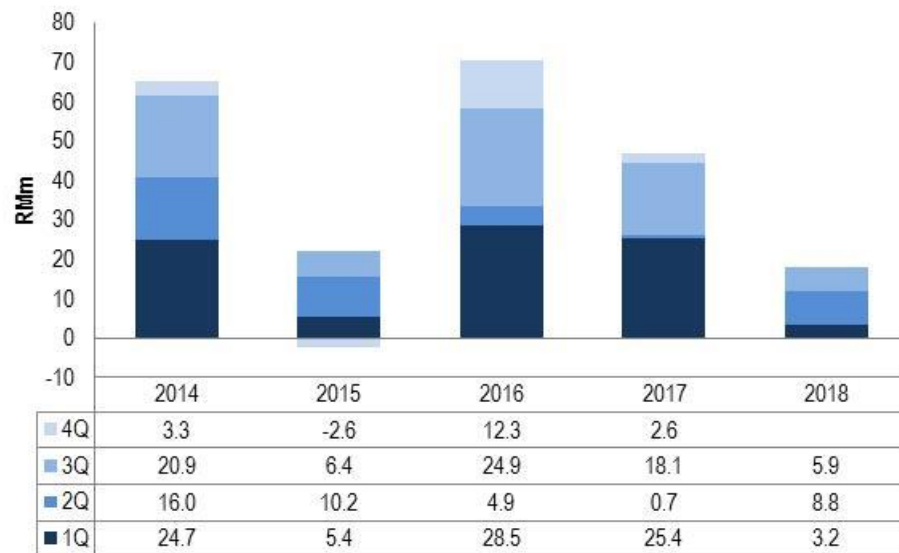
Euromonitor International Passport – Consumer Foodservice 2018 edition; HLIB

Financials

Earnings review – weak earnings will protract into FY18. After hitting a multi-year record high core net profit of RM73.6m in FY16, core net profit in FY17 took a 36% dive to RM46.9m (see Figure #5) as improved performances at flour milling sub-segment (arising mainly from lower wheat prices) and 30%-JV PT Bungasari Flour Mills were negated by (i) weaker performance at grains trading sub-segment arising from intense competition, and (ii) weaker performance at integrated poultry segment arising from lower live broiler prices, lower sales volume of poultry feed and production performance issues. The earnings weakened further to a core net profit of just RM17.9m in 9M18 (see Figure #8), as broiler production performance issues were only rectified in end-1H18 (evidenced by the less-than-inspiring results in 1H18), weak live broiler prices in 3Q18, and weak performance at Indonesian JV unit (arising from intense price competition amidst higher raw material costs, as well as Rupiah depreciation).

Earnings recovery from FY19. Nevertheless, we believe earnings will bottom in FY18 and recover to RM59.4m and RM62.0m in FY19-20, underpinned by (i) improved broiler production performance (as the issue has already been rectified since end-1H18), (ii) higher production capacity at downstream processing sub-segment, which carries better profitability via-s-vis live birds, (iii) turnaround at 30%-owned JV as price competition has eased since 3Q18, and (iv) higher aqua feed sales volume.

Figure #7 Historical quarterly core earnings trend

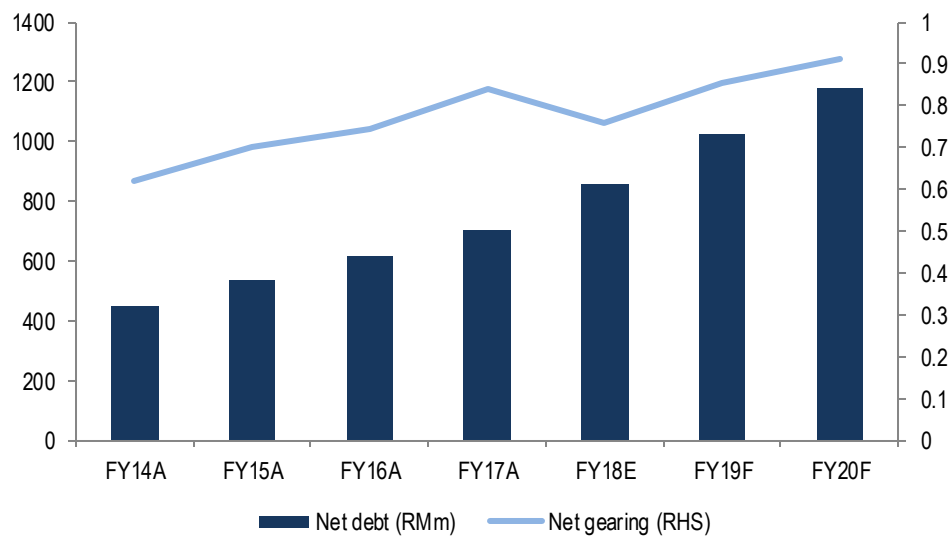


* FY16 core net profit surged on (i) higher flour and grains sales, (ii) improved sales volume and selling prices at the integrated poultry segment, and (iii) turnaround at 30%-owned JV PT Bungasari Flour Mills.

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Balance sheet – net gearing to remain at circa 0.9x despite major capex. MFM had net debt and net gearing of RM701.5m and 0.84x in FY17. While net debt will remain on a rising trend over the next few years (arising from its major capex spending at its poultry integration segment over the next 2 years), net gearing will remain stable at circa 0.9x over the next 3 years (see Figure #8), on the back of the fund raising exercise.

Figure #8 Historical gearing trend



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Valuation & Recommendation

We derive a fair value of RM0.72 on MFM by using sum-of-parts valuation (see Figure #9), i.e. (i) 12x FY19 core net profit for flour and grains segment, in line with MSM Malaysia's valuation multiple given the similarities shared between MFM and MSM, (ii) 10x FY19 core net profit for poultry integration segment, in line with the smaller sized integrated poultry players in Malaysia, and (iii) adding on proceeds from its fund-raising exercise.

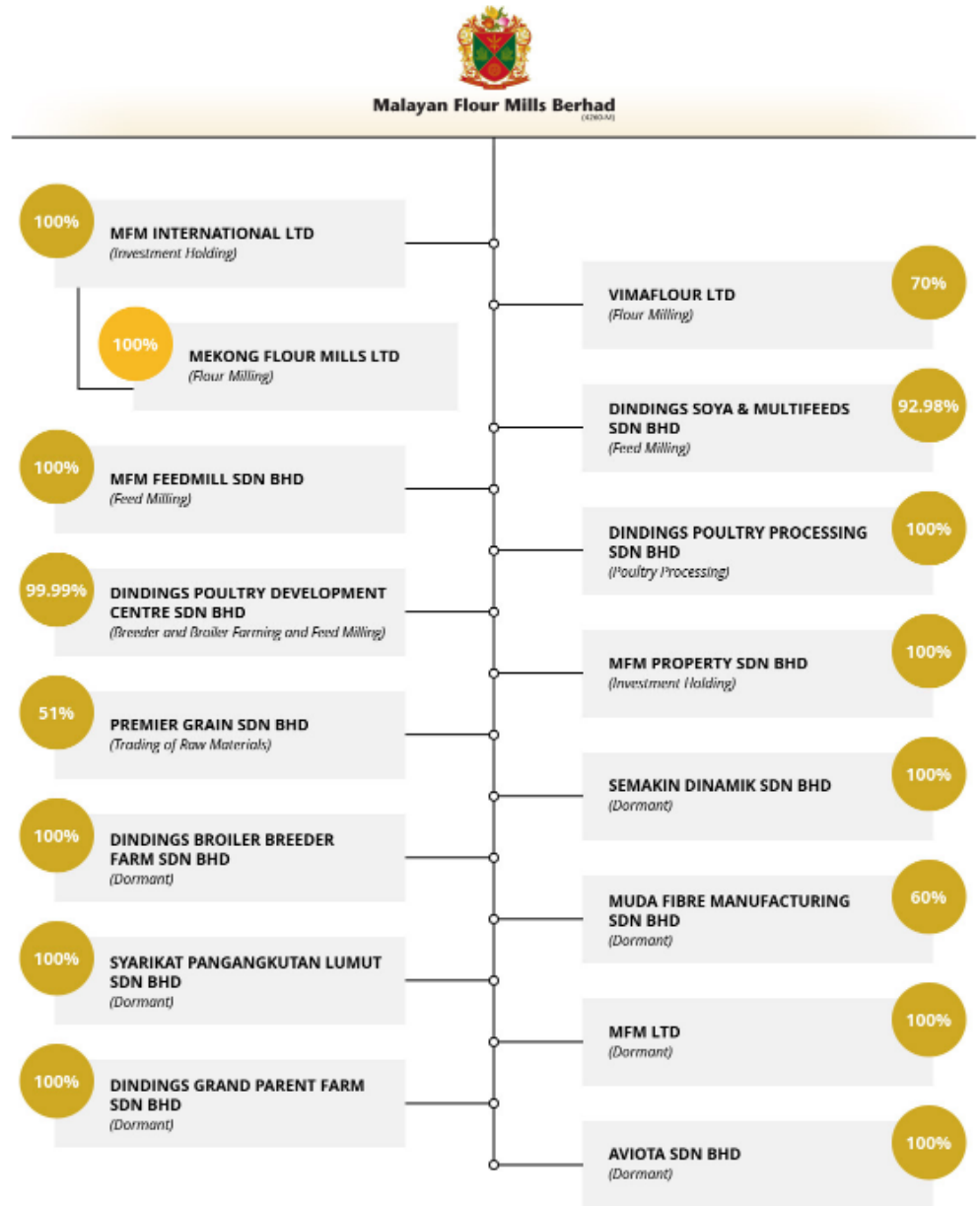
Figure #9 **Sum-of-parts valuation**

Divisions	RMm
Flour & grains (12x FY19 core net profit)	470.8
Poultry integration (10x FY19 core net profit)	110.4
	<u>581.2</u>
Proceeds from:	
- Rights issue of RCULS & shares	220.0
- Conversion of warrants	74.8
	<u>876.0</u>
Enlarged issued shares (m)	1,210.3
Fair value (RM/share)	<u>0.72</u>

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Appendices

Figure #10 Corporate structure



MFM

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Stock rating definitions

BUY	Expected absolute return of +10% or more over the next 12 months.
HOLD	Expected absolute return of -10% to +15% over the next 12 months.
SELL	Expected absolute return of -10% or less over the next 12 months.
UNDER REVIEW	Rating on the stock is temporarily under review which may or may not result to a change from the previous rating.
NOT RATED	Stock is not or no longer within regular coverage.

Sector rating definitions

OVERWEIGHT	Sector expected to outperform the market over the next 12 months.
NEUTRAL	Sector expected to perform in-line with the market over the next 12 months.
UNDERWEIGHT	Sector expected to underperform the market over the next 12 months.