Fraser and Neave

Lacking the pop factor

SINGAPORE | CONSUMER | UPDATE

- In a phase to fill in the gap due to loss of sales from its Beer business and *Red Bull*
- Lack of near term catalyst: new markets are still in nascent stage and no concrete acquisition plan yet
- Actions taken to improve sales and margins, but will not return to FY2014-level

Persistent macro headwinds dampen ASEAN consumer sentiment

We expect cautious consumer spending in the region to continue weighing against topline, and growth should remain tepid following the divestment of MBL business. Meanwhile, Fraser and Neave, Limited (FNN) leverages on strategic partnerships to build presence in new markets.

Losing momentum after the sale of Myanmar Brewery Limited (MBL)

To recap, its Beer segment accounts for c.38% of FNN's FY2014 EBIT with c.33% EBIT margin.

(a) **Dairies is the only bright spot now.** Low commodity prices and favourable product mix buoyed margins. We expect Dairies' high EBIT margin of 12% to sustain into FY17F. However, due to lack of new geographical markets, there is limited room for Dairies to grow its topline.

(b) **Without a strong growth driver, the Group's focus is now on margin enhancement initiatives and strengthening of its distribution network.** But overcapacity issues in soft drinks still lingers post *Coca*-Cola's departure. On the other hand, with a low single-digit royalty fees, we do not think the cross-production distribution from its partnership with Thai Beverage Public Company Limited (ThaiBev) could contribute much to the bottom line during its brand building phase. On that note, we also think that higher marketing costs will erode their bottom line.

We do not expect growth and margins to return to FY2014 level. But, we noted potential re-rating catalyst, and the question remains as: When and How?

Vietnam is on state divestment drive, with two deals on the street: Vinamilk and Saigon Alcohol Beer and Beverages Corporation (SABECO). However, the divestment process has been going very slowly. Vietnam government announced its intention in mid-2015 but has yet to detail plans for the divestment, stating that it will sell its stakes only when it has identified new investments that are more profitable. Market may be celebrating a little too early.

50% dividend payout policy attainable in FY16-17F. Proceeds from MBL-sale provides plenty of capital headroom for the Group to expand. While there is no concrete acquisition plan yet, we expect FNN's net cash position to strengthen to S$1.05bn and S$1.11bn at end-FY16F and FY17F, respectively, from the current S$0.97bn (as at 30 June 2016).

Investment Risks

(a) Adverse foreign exchange movement could erode margins
- at least 80% of the cost of raw materials are denominated in USD
- c.77% of sales are derived from outside out Singapore

(b) Turnaround in prolonged low raw material prices would compress margins

Investment Actions

In view of macro headwinds and cautious consumer sentiment, and lack of significant growth catalyst, we reset the FY17F EV/EBITDA multiple to peer average's 10.0x (from 12.8x). With the change of analyst, we downgraded our **TP to S$1.93** (from S$2.40) and maintain "**Reduce**" rating.

22 August 2016

Reduce (Maintain)

LAST CLOSE PRICE	SGD 2.12
FORECAST DIV	SGD 0.04
TARGET PRICE	SGD 1.93
TOTAL RETURN	-7.1%

COMPANY DATA

O/S SHARES (MN) :	1446
MARKET CAP (USD mn / SGD mn) :	2275 / 3065
52 - WK HI/LO (SGD) :	2.31/ 19
3M Average Daily T/O (mn) :	0.05

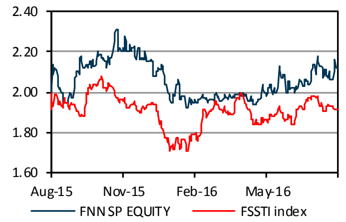
MAJOR SHAREHOLDERS (%)

TCC ASSETS LTD	59.35%
THAI BEVERAGE PCL	28.53%

PRICE PERFORMANCE (%)

	1MTH	3MTH	1YR
COMPANY	2.4	6.3	2.3
STI RETURN	(103)	5.45	(2.81)

PRICE VS. STI



Source: Bloomberg, PSR

KEY FINANCIALS

Y/E Sep	FY14	FY15	FY16F	FY17F
Revenue (SGD mn)	2,093	2,104	1,991	2,005
EBITDA (SGD mn)	330	209	220	223
NPAT (adj.) (SGD mn)	263	115	105	108
EPS adj. (SGD)	0.18	0.08	0.07	0.07
PER, adj. (x)	17.2	26.9	29.7	28.7
P/BV, (x)	2.8	1.4	1.3	1.3
DPS (SGD)	0.05	0.05	0.04	0.04
Div Yield (%)	1.6%	2.3%	1.7%	1.7%
ROE (%)	5.2%	6.0%	4.5%	4.5%

Source: Company Data, PSR est.

Valuation Method

EV/EBITDA Multiple (10x)

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Ref. No.: SG2016_0186

A mixed picture in ASEAN

ASEAN: Overall good, but markets where FNN operates in are challenging

- Weighed by the uncertainties arising from Brexit, coupled with the muted US growth and Chinese economy slowdown, the International Monetary Fund (IMF) has cut global growth forecast by 0.1 percentage point for 2016 and 2017 to 3.1% and 3.4%, respectively.
- Although ASEAN economies are expected to grow above global average at 4.8% and 5.1% in 2016 and 2017 respectively, we expect soft demand in FNN's key markets to extend into the rest of 2016 and 2017. Spillover of increased global uncertainties has caused slower growth and greater currencies fluctuations in FNN's key markets, namely, Malaysia, Singapore and Thailand.

Malaysia (c.47% of its total FY2015 revenue)

- Bank Negara expects Malaysia's **economy to slow from 4.7% in 2015 to between 4% and 4.5% in 2016. In view of the broader economic climate and local events, Malaysians are adopting cautious spending.**

Singapore

- Economic growth remains lacklustre. The Ministry of Trade and Industry (MTI) has narrowed the growth forecast for Singapore's economy in 2016 to between 1% and 2%, down from the initial range of between 1% and 3%.

Thailand

- Thailand's growth has picked up slightly since a military junta seized power in May 2014. The Chamber of Commerce has set a target of at least 3.3% economic growth for 2016. However, domestic consumption remains subdued. Consumer sentiment hit 2-year low in June 2016 amidst slow economic growth and political uncertainties.

Figure 1:

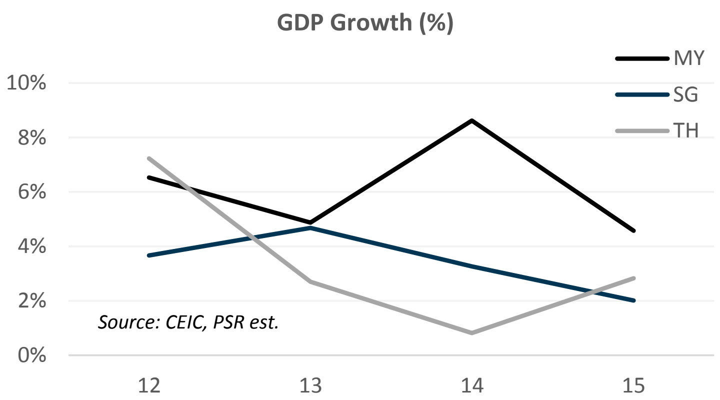
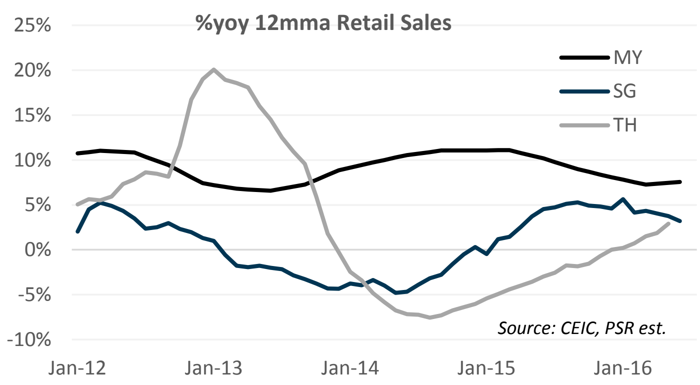


Figure 2:



Business ex-MBL will never be the same

FY2015 was cruel to FNN. Not only was it forced to sell its key growth and margin driver, the Beer business, it also lost its distributorship rights on *Red Bull* and *Milo UHT*. To recap, its Beer segment accounts for c.38% of FNN's FY2014 EBIT with c.33% EBIT margin. Beverages Malaysia segment took a hit from loss of sales from *Red Bull*. 9MFY2016 revenue fell 5% year-on-year (yoy) in constant currency term and volume increased 7% yoy. Stripping off *Red Bull*'s contribution, growth in 9MFY2016 topline and volume would have been 14% and 12%, respectively.

Dairies supported margin, but there is limited room for Dairies to grow its topline due to lack of new geographical markets. It is not sufficient to depend solely on Dairies to drive growth and profitability.

Dairies is the sole business segment which logged a positive year-on-year (yoy) growth in FY2015 EBIT. It contributed to at least half of the Group's total EBIT with EBIT margin at c.6% in FY2015. Thanks to the low milk-based commodity costs, Dairies accounts for c.71% of 9MFY2016 EBIT with EBIT margin expanding to a remarkable 12%.

Figure 6:

Source: Company, PSR est.

Without a strong growth driver, the Group can only (i) help its profit margin by enhancing economies of scale and (ii) draw new demand by expanding its distribution network and introducing new products to boost sales. **Its forays into new markets are still at an infant stage**.

Therefore, we expect the Group to fund more advertising and promotion activities to strengthen market position while building new markets using the proceeds from the sale of its 55% stake in MBL. The sale resulted in a net gain of $542mn (after cost of investment and taxes), boosting its cash balance to almost S$1bn at end-FY2015.

New markets: Seeding stage

FNN intends to replicate its successful business models in other ASEAN countries, in particular Vietnam, Myanmar, and Indonesia in the next three years. Its ultimate aim is to establish itself as one of the top three food and beverage players in these markets.

The Group has started its first move with the products it is most familiar with – Soft Drink.

New markets provide new avenues for growth, but it would take time to yield returns. Hence, **we do not expect the sales from these markets to flow through to the bottom line, as most of the proceeds will be plough back to fund the intense marketing costs.**

New Market	Remarks
Vietnam	▪ Set up a representative office in Ho Chi Minh City in June 2015 ▪ Launched *100Plus* in 400 modern trade distribution points in Vietnam, in particular convenience stores
Myanmar	▪ Established a branch office in Yangon in 2014 ▪ Introduced *100Plus* in 2012 and ranked no. 1 in Isotonic Drinks market share ▪ Introduced *F&N Seasons Ice Lemon Tea* in 2015

M&A, a faster way to tap into new markets, but...

Given its established brand name and huge cash position, we think that acquisitions would be the Group's preferred and more favourable route compared to organic approach.

In our view, a profitable business with a strong distribution network would be the Group's potential acquisition target as it could tap into the existing distribution network and accelerate the expansion process in a foreign market.

Speed bump along the way, particularly in Vietnam

The Vietnamese government has been on privatisation drive in recent years. However, the divestment drive has slowed and even been delayed many times, with the government reportedly unwilling to sell its stake for fear of losing interest in such a profitable company.

Two well-known stake sales in the industry – Vinamilk, Vietnam's largest dairy producer, and Saigon Alcohol Beer and Beverages Corporation (SABECO), the country's beer and beverage giant.

Some background on these companies:

- **Vinamilk:** Removing the 49% foreign ownership cap. State owns 45%, while FNN holds 11%. The company is valued at US$1.52bn by Forbes with FY2015 PATMI at US$320mn. It has consistently paid huge dividends over the years – dividend payout ratio of at least 50% since 2012 and 91.4% in 2015.
- **SABECO:** Reducing stake from 89.59% to 36%. The company is valued at about US$247mn by Forbes. It controls more than half of Vietnam's beer market with its iconic Saigon brand.

Successful acquisition(s) would add accretive growth prospects to the Group, leading to potential re-rating of the stock. Especially, a stake in SABECO could regain some lost ground due to the absence of high margin brewery arm post MBL-sale.

Having said the above, the State Capital Investment Corporation (SCIC), Vietnam's sovereign fund, only announced plans to sell its holdings but has no set official time frame on when and how the divestment process would be. The SCIC recently stated that it will sell its stakes only when it has identified new investments that are more profitable.

In addition, we expect that the firms' shares will receive strong interest from foreign investors, pushing up prices. We remain cognizant of the possibility where FNN may overpay for the deals, diminishing the attractiveness of the deal.

Do not expect significant contributions from recent developments

Scaling up Dairies; but overcapacity in Soft Drinks

We view the recent c.S$70mn CAPEX in Malaysia positively, as the new UHT lines would increase capacity for Dairies which is currently operating at full capacity. Meanwhile, the new packaging lines and additional storage capacity could generate cost efficiencies and improve margins.

On the other hand, we are less excited on the new soft drinks plant in Sabah, as the Group still has excess capacity for soft drinks production after *Coca-Cola*'s departure.

Additional Capacities in Malaysia	Target to be operational by	Capital expenditure committed
New UHT lines (Kuching) ▪ Produces 3.4mn cases per year	end-2016	c.S$70mn (RM210mn)
New aseptic cold-filling PET bottle line, housed within the new integrated four-storey warehouse (Selangor) ▪ Offers new formulations and packaging formats and four-fold increase in storage capacity ▪ Produces 6.5mn cases per year ▪ Reduces PET resin packaging material by 40%	2017	
New soft drinks plant (Sabah) ▪ Doubling capacity of its current plant in Kota Kinabalu (2015 capacity at c.4mn cases per annum)	2021	c.S$30mn (RM100mn)

Expanding distribution network, but…

- Singapore's contribution to bottom line is minimal (c.23% and c.-6% to its revenue and EBIT in FY2015, respectively)
- Royalty fee from ThaiBev is a low single-digit on net sale revenue
- Weaker currencies eroded overall growth in Malaysia

Additional distribution network	Remarks
Acquisition of Warburg	▪ Moves FNN from no. 3 to a strong no. 2 player, in terms of vending space in Singapore, following *Coca-Cola*. The Group's total number of active vending machines is set to increase almost threefold. ▪ Acquisition cost of c. S$29mn was funded internally and fully in cash.
Ramping up partnership with ThaiBev with cross-product distribution	▪ *100Plus, F&N Seasons* and *F&N Nutrisoy* were launched in Thailand last year. In less than a year of its launch, *100Plus* has captured 11% market share of the isotonic segment in Thailand. ▪ *Oishi* green tea was launched in Singapore in March 2015, following Malaysia's launch in 2013. ▪ *Coco Life* was launched in Singapore and Malaysia in 2015. It was well received particularly in Malaysia, where it successfully captured 12% market share of the coconut juice category within a month. Partnering airline AirAsia in December 2015 provides access to inflight demand. ▪ **Filling in the gap, but yet to see results** i. *Ranger* and *EST* Cola were introduced in Malaysia since June 2015 to replace its loss of sales from energy drink (*Red Bull*) and cola segment (*Coca-Cola*), respectively ii. *CHANG* beer has been distributed in Singapore since October 2015 to replace its loss of sales from beer

Assumptions and forecasts

We have adjusted our assumptions to reflect post MBL-sale, namely (i) changes in product mix, (ii) potential demand and capacity growth arising from new facilities and new markets; as well as (iii) margin improvements on the back of weaknesses in commodity prices and economies of scale.

1. Soft drinks

- We expect a turnaround in FY17F as the impact from loss of sales from *Red Bull* diminish, and lifted by *100Plus* sales growth in Thailand and the new markets.
- However, EBIT margin is expected to remain at c.5% in FY17F, taking into consideration of gain from economies of scale, offset by higher sugar prices. Malaysia increased its refined sugar price by c.38.9% in August 2016, and sugar comprises 20% to 25% of its total raw material costs.

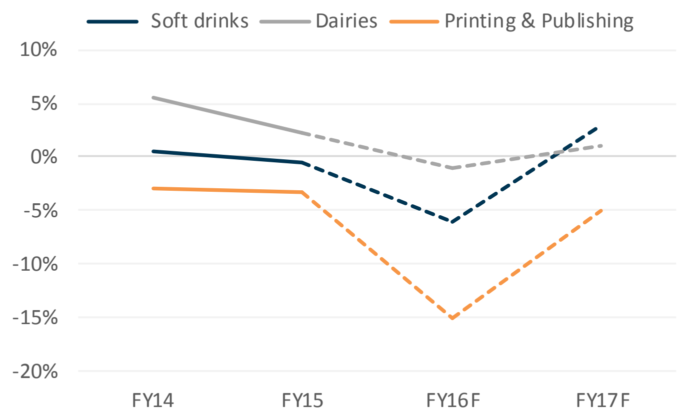
2. Dairies

- We expect tepid demand for Dairies due to a lack of new geographical markets, offset by higher take up rate for *Farmhouse* UHT milk which was introduced in Malaysia in June 2015.
- EBIT margin is expected to sustain at c.12% in FY17F, as milk-based commodity prices remain under pressure, weighed by oversupply issue.

3. Printing and Publishing (P&P)

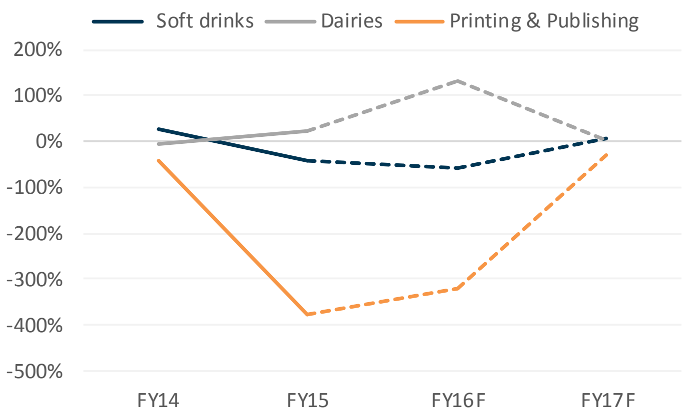
- We expect EBIT margin to improve post-restructuring exercise in its print business. The Group is in the midst to diversify printing services and products and improve operating efficiencies, by rightsizing both workforce and printing capacity.
- However, we expect its P&P segment to remain challenging, due to: higher operating costs, weakening Australian dollar (Australia is the primary market) and lower demand on the back of poor consumer sentiments and threat from e-print.

Figure 6:
Revenue Growth



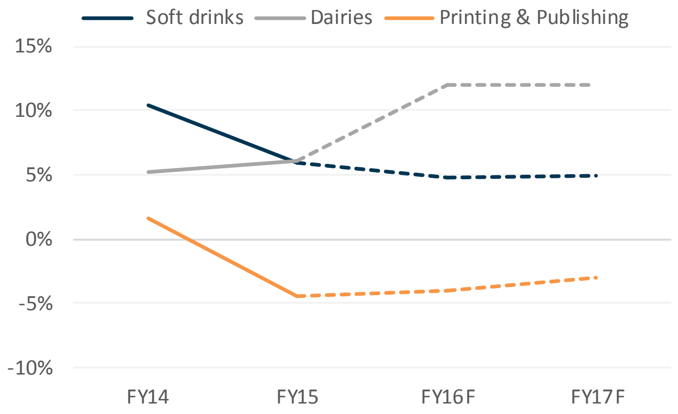
Source: Company, PSR est.

Figure 7:
EBIT Growth



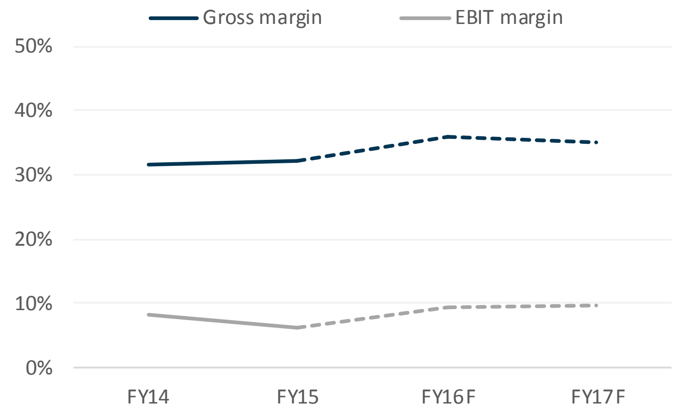
Source: Company, PSR est.

Figure 8:
Segment: EBIT Margin



Source: Company, PSR est.

Figure 9:
Margins



Source: Company, PSR est.

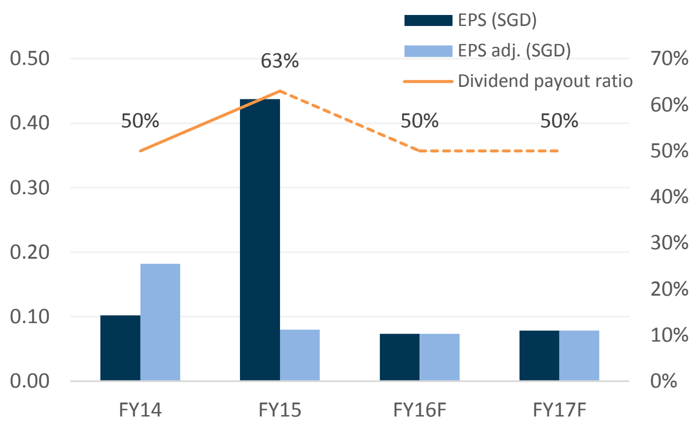
4. Dividends

The Group has a dividend policy of paying up to 50% of PATMI.

We forecast a 50% dividend payout ratio in FY16-17F, on the back of its cash rich position and there is no concrete acquisition plan yet. Positive cash flow generation, coupled with the net proceeds from the MBL-sale, we expect cash to hit S$1bn mark by end-FY2016F and end-FY2017F, providing plenty of capital headroom.

Having said the above, the Group has S$0.6bn in banking facilities and S$2.5bn in MTN Programmes to meet its funding requirements. As at 30 Sep-15, the Group has a net cash of S$865.1mn.

Figure 10:



Valuation

In view of macro headwinds and cautious consumer sentiment, and lack of significant growth catalyst, we reset the FY17F EV/EBITDA multiple to peer average's 10.0x (from 12.8x).

With the change of analyst, we downgraded our **TP to S$1.93** (from S$2.40), based on estimated S$223mn FY17 EBITDA and maintained "**Reduce**" rating.

Peer Comparison

FNN currently trades at 29.7x FY16F PER, which is c.62% premium to its ASEAN peers' 18.3x. We think that the premium valuation is not justifiable given the slower growth post MBL-sale.

It also has lower return-on-equity (ROE), as compared to its ASEAN peers.

These support our thesis of 'Reduce' rating.

Figure 11:

Company	Mkt Cap (SGD mn)	EV (SGD mn)	EV/EBITDA TTM	EV/EBITDA FY1	EV/EBITDA FY2	P/E	P/E FY1	P/E FY2	Net D/E (%)	ROA (%)	ROE (%)	P/B
Fraser and Neave Ltd	3,065	2,535	78.1	11.5	11.4	26.9	29.7	28.7	Net Cash	4.0	6.0	1.4
ASEAN												
Fraser & Neave Hldgs Bhd	3,010	2,992	17.3	15.0	14.0	22.9	21.2	19.4	Net Cash	12.7	21.3	4.7
Alliance Global Group Inc	4,781	9,173	9.0	8.8	8.4	11.9	11.2	11.1	47.3	3.2	9.9	1.1
Pepsi-Cola Products Philippines Inc	375	488	5.4	5.0	4.5	16.0	14.0	12.1	-5.8	3.8	9.2	1.5
Super Group Ltd	852	746	9.9	8.4	8.0	19.1	18.2	16.6	Net Cash	7.0	8.8	1.7
Ultrajaya Milk Ind & Trading	1,402	1,296	12.0	12.9	11.0	23.0	21.7	18.1	Net Cash	17.0	21.4	4.5
Vietnam Dairy Products JSC	12,524	11,935	14.1	16.4	15.1	25.4	23.8	21.3	Net Cash	31.6	37.1	9.1
Yeo Hiap Seng Ltd	737	648	17.0	N/A	N/A	19.7	N/A	N/A	Net Cash	5.2	6.1	1.2
Simple Average (Excl. FNN)			12.1	11.1	10.2	19.7	18.3	16.5	20.8	11.5	16.3	3.4

Source: Bloomberg, Phillip Securities Research (Singapore) Estimates

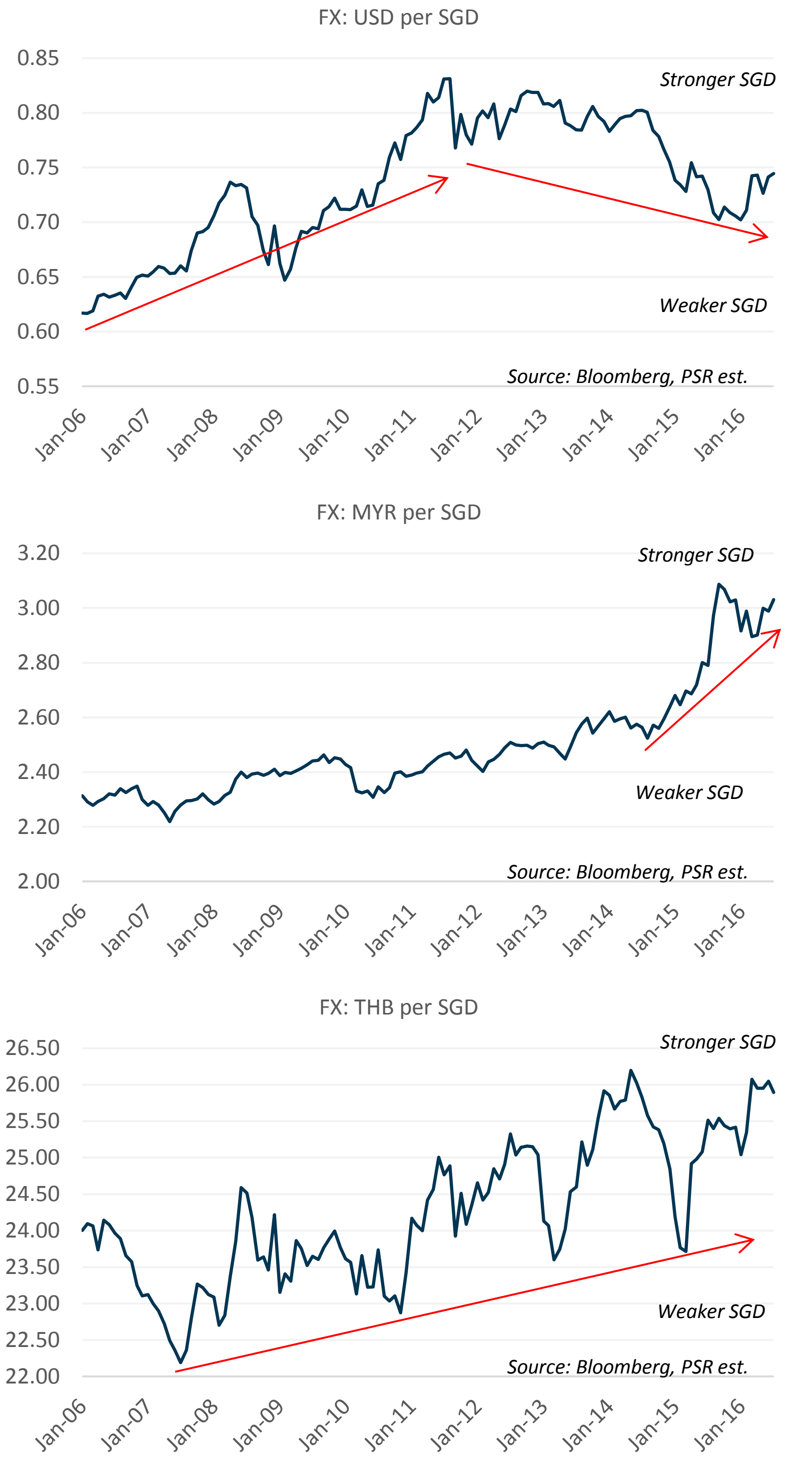
Investment Risks

1. Adverse foreign exchange movement

- Stronger USD against SGD (at least 80% of the cost of raw materials are denominated in USD)
- Stronger SGD against MYR and THB (c.77% of sales are derived from outside of Singapore)

2. Turnaround in prolonged low raw material prices would compress margins

Figure 12-14: FX rate trend



PhillipCapital

Financials

Income Statement

Y/E Sep, SGD mn	FY14	FY15	FY16F	FY17F	FY18F
Revenue	**2,093**	**2,104**	**1,991**	**2,005**	**2,039**
Gross profit	659	679	717	702	714
EBITDA	**330**	**209**	**220**	**223**	**226**
Depreciation & Amortisation	(85)	(92)	(63)	(62)	(62)
EBIT	**170**	**132**	**187**	**194**	**200**
Net Finance Inc/(Exp)	9	0	9	9	10
Associates & JVs	2	3	3	3	3
Other items	(78)	12	28	30	33
Profit Before Tax	**178**	**132**	**197**	**202**	**210**
Taxation	(27)	(19)	(33)	(34)	(36)
Profit After Tax (Con. Ops)	**152**	**112**	**163**	**168**	**174**
Profit After Tax (Discon. Ops)	**205**	**637**	-	-	-
- Non-controlling interest	(109)	(87)	(59)	(60)	(61)
Net profit, reported	**147**	**633**	**105**	**108**	**113**
Net profit, adj.	**263**	**115**	**105**	**108**	**113**

Per share data (SGD)

Y/E Sep	FY14	FY15	FY16F	FY17F	FY18F
EPS, reported	0.10	0.44	0.07	0.07	0.08
EPS, adj.	0.18	0.08	0.07	0.07	0.08
DPS	0.05	0.05	0.04	0.04	0.04
BVPS	1.11	1.57	1.63	1.69	1.75

Cash Flow

Y/E Sep, SGD mn	FY14	FY15	FY16F	FY17F	FY18F
CFO					
EBIT	170	132	187	194	200
Depreciation & Amortisation	85	92	63	62	62
WC changes	(193)	(18)	(23)	1	(4)
Tax paid	(50)	(34)	(33)	(34)	(36)
Others	188	54	(30)	(33)	(35)
Cashflow from ops	199	225	164	189	187
CFI					
CAPEX, net	(1,039)	(68)	(60)	(60)	(61)
Others	(536)	600	16	18	21
Cashflow from investments	(1,575)	532	(44)	(42)	(40)
CFF					
Share issuance, net	7	3	-	-	-
Loans, net of repayments	648	(17)	41	-	-
Dividends	(257)	(102)	(74)	(83)	(86)
Others	(607)	(10)	-	-	-
Cashflow from financing	(209)	(126)	(33)	(83)	(86)
Net change in cash	(1,585)	632	87	64	61
Effects of exchange rates	(3)	(25)	-	-	-
Asset reclassification	-	(0)	-	-	-
CCE, end	**355**	**962**	**1,048**	**1,112**	**1,172**

Balance Sheet

Y/E Sep, SGD mn	FY14	FY15	FY16F	FY17F	FY18F
ASSETS					
PPE	661	464	475	485	495
Intangibles	124	106	92	80	69
Investments in Assoc/JV	50	42	45	47	50
Others	845	965	1,045	1,125	1,207
Total non-current assets	**1,680**	**1,577**	**1,657**	**1,738**	**1,822**
Accounts receivables	360	332	355	357	363
Cash	355	962	1,048	1,112	1,172
Inventories	274	254	244	250	254
Others	6	17	17	17	17
Total current assets	**995**	**1,565**	**1,664**	**1,737**	**1,807**
Total Assets	**2,675**	**3,143**	**3,321**	**3,474**	**3,629**
LIABILITIES					
Accounts payables	394	384	393	399	406
Short term loans	23	3	12	12	12
Others	47	50	50	50	50
Total current liabilities	**494**	**446**	**446**	**455**	**462**
Long term loans	119	98	129	129	129
Others	61	42	42	42	42
Total non-current liabilities	**180**	**140**	**171**	**171**	**171**
Total Liabilities	**674**	**587**	**618**	**626**	**633**
EQUITY					
Non-controlling interests	396	288	347	406	467
Shareholder Equity	**1,605**	**2,268**	**2,357**	**2,442**	**2,529**

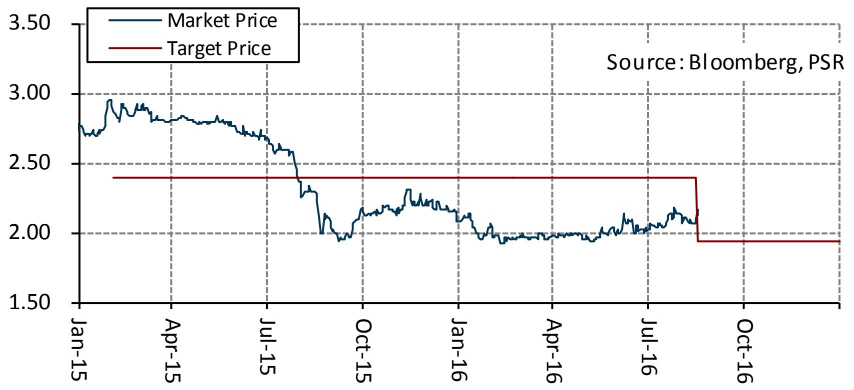
Valuation Ratios

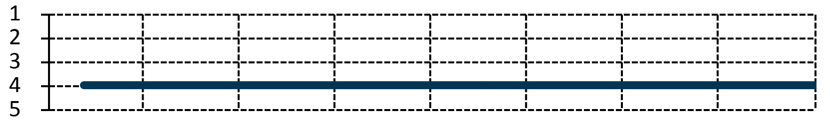
Y/E Sep	FY14	FY15	FY16F	FY17F	FY18F
P/E (X), adj.	17.2	26.9	29.7	28.7	27.4
P/B (X)	2.8	1.4	1.3	1.3	1.2
EV/EBITDA (X), adj.	14.3	12.1	11.4	11.2	11.0
Dividend Yield (%)	1.6%	2.3%	1.7%	1.7%	1.8%
Growth & Margins (%)					
Growth					
Revenue	-8.8%	0.5%	-5.4%	0.7%	1.7%
EBITDA	-28.0%	-36.6%	5.2%	1.4%	1.6%
EBIT	-20.7%	-22.4%	42.4%	3.3%	3.4%
Net profit, adj.	-51.7%	-56.1%	-9.2%	3.4%	4.5%
Margins					
Gross margin	31.5%	32.3%	36.0%	35.0%	35.0%
EBITDA margin	15.7%	9.9%	11.0%	11.1%	11.1%
EBIT margin	8.1%	6.3%	9.4%	9.7%	9.8%
Net profit margin	12.6%	5.5%	5.3%	5.4%	5.6%
Key Ratios					
ROE (%)	5.2%	6.0%	4.5%	4.5%	4.6%
ROA (%)	3.1%	4.0%	3.2%	3.2%	3.2%
Net Debt/(Cash)	(213)	(861)	(907)	(971)	(1,031)
Net Gearing (X)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash

Source: Company, Phillip Securities Research (Singapore) Estimates

*Forward multiples & yields based on current market price; historical multiples & yields based on historical market price.

Ratings History





PSR Rating System

Total Returns	Recommendation	Rating
> +20%	Buy	1
+5% to +20%	Accumulate	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce	4
<-20%	Sell	5

Remarks

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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