

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 660.3m	Recommendation:	BUY
Target Price:	RM 2.03	Expected Capital Gain:	69.2%
Current Price:	RM 1.20	Expected Div Yield:	4.6%
		Expected Total Return:	73.8%
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	9.2	13.2
P/E (x)	8.2	9.6	13.0	9.1
Net Dividend/Share (sen)	6.5	6.5	5.5	5.5
NTA/Share (RM)	1.51	1.51	1.55	1.63
Book Value/Share (RM)	1.51	1.52	1.55	1.63
Issued Capital (mil shares)	550.2	550.3	550.3	550.3
52-weeks Share Price Range (RM)			1.20 - 2.37	
Estimated free float				45%
Average volume (shares)				363,360

Per Share Data	2016	2017	2018F	2019F
Year-end 31 Dec				
Book Value/Share (RM)	1.51	1.52	1.55	1.63
Operating CF/Share (sen)	7.7	21.6	24.0	18.9
EPS (sen)	14.7	12.5	9.2	13.2
Net Dividend/Share (sen)	6.5	6.5	5.5	5.5
P/E (x)	8.2	9.6	13.0	9.1
P/Cash Flow (x)	15.5	5.6	5.0	6.3
P/Book Value (x)	0.8	0.8	0.8	0.7
Dividend Yield (%)	5.4	5.4	4.6	4.6
Payout Ratio (%)	44.2	52.2	59.6	41.5
ROE (%)	10.1	8.2	7.2	10.1
Net Gearing (%)	74.3	84.1	111.1	108.7

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	148.22	177.56
Depreciation & amort	(47.70)	(53.38)	(67.92)	(69.87)
Net interest income	(10.52)	(11.90)	(15.80)	(19.13)
JV & associates	6.73	7.74	2.30	7.30
Pre-tax Profit	111.32	96.49	66.80	95.86
Net Profit	80.84	68.57	50.77	72.85
EBITDA Margin (%)	6.4	6.4	6.2	7.0
Pre-tax Margin (%)	4.4	4.0	2.8	3.8
Net-Margin (%)	3.2	2.9	2.1	2.9

1. 2QFY18 Results Highlight

	2Q FY18	2Q FY17	Chg
	RMm	RMm	%
Revenue	547.68	575.93	(4.9)
Operating Profit	14.11	22.16	(36.3)
Net finance cost	(2.47)	(2.58)	(4.1)
JV & Associates	(3.53)	1.90	n.m.
Pre-tax Profit	8.11	21.47	(62.3)
Net Profit	4.77	16.15	(70.5)
Operating Margin (%)	2.6	3.8	
Pre-tax Margin (%)	1.5	3.7	
Net-Margin (%)	0.9	2.8	

- Group turnover declined 4.9% to RM547.68m in 2QFY18 mainly due to lower sales contribution from its poultry integration division.
- Both PBT and net profit declined 62% and 70% to RM8.11m and RM4.77m in 2QFY18 respectively. The sharp decline in profits in the quarter was attributed to substantially lower profit contribution from the poultry integration division, and losses at its 30%-owned JV in Indonesia.

- In 1QFY18, the flour and grains trading division was a drag on profits, where its EBIT declined 74% to RM5.86m, undermined by rising wheat cost that it was unable to pass on in the form of higher selling price as a result of stiff competition. Nonetheless, this division had shown an operational improvement in 2QFY18, where both turnover and EBIT were relatively unchanged at RM381.31m and RM11.66m on a yoy basis. Compared to 1QFY18, EBIT doubled to RM11.66m, driven by higher sales volume, a slight price increase as well as sourcing and operations efficiency which helped to improve profit margin in 2QFY18.
- Turnover of its poultry integration division declined 17% to RM166.37m in 2QFY18, being still impacted by production performance issue that started in 4QFY17. It reported a lower EBIT of RM2.48m in 2QFY18 as compared with an EBIT of RM11.12m in 2QFY17. This was also caused by a net fair value loss on biological assets of RM1.61m (2QFY18) as compared with a gain of RM7.01m (2QFY17). Excluding the impact of this fair value gain/loss, its operating EBIT would have been flattish at RM4.09m in 2QFY18. Although there has been signs of improvement in the production of day-old-chicks after MFM initiated action plans since end-FY17, the poultry integration division also subsequently faced pressures on lower selling price and lower margin of sales of live birds in 2QFY18. Nonetheless, its chicken production volume has improved since 2QFY18, with production expected to be fully normalised in 3QFY18.
- Its 30%-owned flour milling operation in Indonesia under PT Bungasari Flour Mills Indonesia (PTBFMI) reported a net loss of RM3.56m (2QFY18) from a net profit of RM1.90m (2QFY17). The net loss was attributed to the weaker IDR against US\$ and price competition.
- At core operating level, group EBIT (excluding fair value gain/loss) was slightly higher at RM15.72m in 2QFY18 as compared with RM15.15m in 2QFY17.

1H FY18 Results Highlight

	1H FY18	1H FY17	Chg
	RMm	RMm	%
Revenue	1,111.49	1,180.10	(5.8)
Operating Profit	21.56	57.91	(62.8)
Net finance cost	(5.95)	(4.86)	22.4
JV & Associates	(5.06)	2.22	n.m.
Pre-tax Profit	10.56	55.27	(80.9)
Net Profit	6.37	41.06	(84.5)
Operating Margin (%)	1.9	4.9	
Pre-tax Margin (%)	0.9	4.7	
Net-Margin (%)	0.6	3.5	

- While group turnover declined by 5.8% to RM1,111.49m in 1HFY18, both PBT and net profit fell sharply by 80-85% to RM10.56m and RM6.37m.
- This was attributed to lower profit contribution from all segments, namely flour and grains trading (high wheat cost and market competition), poultry integration (production performance issue and lower sales volume) and JV in Indonesia (market competition).
- The poorer profit performance was further compounded by a fair value loss (biological assets of poultry division) of RM6.60m (1HFY18) from a gain of RM9.67m (1HFY17). At the core operating level, group EBIT (excluding fair value gain/loss) declined 42% to RM28.16m in 1HFY18 from RM48.24m in 1HFY17.

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, which has been on rising trend, reaching US\$5.50/bushel in Jul-18 from US\$4.00-4.50 in Jan-18. The higher sales volume, slight price increase, sourcing and operations efficiency should improve its profit margin in 2HFY18
- By 3QFY18, the production performance issue of **poultry integration division** should be resolved, and profit margins should improve thereafter. 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 is in the progress of completing the construction of 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

- The reported 1HFY18's net profit, on an annualised basis, is lower than our earnings forecast. We have reduced our earnings forecast slightly for FY18 to account for the continued loss at its Indonesian flour milling operation. Overall, we expect 2HFY18 to be better due to operational improvement of poultry division and improved margin at flour milling 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 target price of RM2.03 upon ascribing an unchanged P/E of 15x on our EPS forecast of 13.2 sen for FY19. Due to the retracement in its share price, it is also currently trading below its book value of RM1.48 as at end-2QFY18.

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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