# Malayan Flour Mills Berhad

*Expecting more earnings upside*

## BUY

Analyst Consensus: Buy 1 Hold 0 Sell 0

| | |
|---|---|
| Share price | RM0.68 |
| Fundamental Score | 0.4/3 |
| Valuation Score | 2/3 |

**Company Description**

Flour milling and trading in flour related products. Diversified to integrated poultry operations including feed mills, breeder farming, broiler farming, poultry processing and further processed products.

**Stock Information**

| | |
|---|---|
| Industry | Consumer |
| Sub-industry | Food & Beverage |
| Bursa Code | 3662 |
| Bloomberg Ticker | MFL MK |
| Listing | Main |
| Outstanding Shares | 951.6 mil |
| Market Cap | RM647.1 mil |
| 52-week Range | 0.468 - 1.431 |
| Est. Free Float | 43.8% |
| Beta | 0.87 |
| 200-day Avg Vol | 2,246,846 |

**Price Performance (%)**

| | 1M | 3M | 12M |
|---|---|---|---|
| Stock | 24.3 | -5.0 | -50.0 |
| FBMKLCI | -0.3 | 1.3 | -8.7 |

**Major Shareholders**

| | |
|---|---|
| The Wee Chye | 18.23% |
| D. Liewphairatana | 10.99% |

We met with Malayan Flour's management team last week to discuss the progress of the company's expansion plans and industry outlook. We feel positive on the overall development and are confident with the profit recovery this year. We made some minor adjustments to our forecast and maintain our **BUY** call.

**Stable revenue growth from Vietnam and Indonesia**

Revenue from flour and grains trading segment totaled RM1.73 billion in FY18, an increase of 5.5% from RM1.64 billion in FY17, driven by higher consumption in Vietnam and Indonesia. Demand is underpinned by growing population, particularly from the middle-income classes.

The stable revenue growth translated into higher operating profit of RM65.9 million in FY18, from RM63.6 million in FY17. However, its operating margin decreased slightly to 3.81% (FY17: 3.88%) in FY18 due to higher wheat costs, which eroded profitability. Wheat price averaged at US$497.8/BU in FY18 as compared to US$439.4/BU in FY17 (↑ 13.3% yoy).

Currently, two of its Vietnam flour mills, Mekong Flour Mills Ltd and Vimaflour Ltd, are running at more than 90% utlisation rate. Its 30%-owned Indonesian associate – PT Bungasari Flour Mills – also reached maximum capacity. However, its Malaysian mills, based in Lumut, Perak and Pasir Gudang, Johor, are still suffering from excess capacity due to intense competition among local players, with utilisation rate averaging at 50% currently.

We maintain our revenue forecast of RM1.85 billion for this segment, supported by additional capacity of 500MT/month in Indoensia. All the necessary equipment is being installed and can be expected to commence operation by 3Q19.

**Margins supported by lower wheat costs and price adjustments**

Recall that its Indonesian operation recorded a net loss of RM6.9 million in FY18 as compared to RM7.7 million in FY17, due predominantly to the price war amongst Indonesian millers and the sharp depreciation of rupiah against the greenback. The largest flour miller in Indonesia – PT Bogasari Flour Mills – did not increase selling prices to protect its market share despite the sharp increase in wheat costs.

Positively, we expect Bungasari to return to profitability this year, given the improved foreign exchange rate and less intense competition. This has, in turn, allowed the company some room for price adjustments.

We also expect Mflour to maintain its operating margin at around 6%, as management has recently increased their pricing in Vietnam. This, coupled with lower wheat prices – trading around US$466/BU at the time of writing.

We believe our forecast is reasonable, given the slight strengthening in the ringgit. Purchases of wheat (80% of production costs) are transacted in US dollar. Management also highlighted that the Malaysian operation will be more selective and focus on profitable customers, which should preserve margins going forward.

**Construction of processing plants well on track**
Revenue for poultry integration segment dropped to RM692.9 million in FY18, a 9% decrease from RM761.4 million in FY17. The business slipped into the red, reporting an operating loss of RM929,000. This was primarily caused by the depressed live bird prices and the unexpected Inclusion Body Hepatitis (IBH), which resulted in higher mortality rate, low feed conversion rate and a downward fair value adjustment for biological assets amounting to RM8.4 million in FY18.

Mflour's expansion programme is separated into three phases. The first phase, which included the construction of a rendering plant and wastewater treatment plant, is completed and commenced operation since end-2018. Under Phase 2, the company is building its primary processing plant, which upon completion should increase its production capacity from 80,000 birds to 240,000 birds slaughtered per day. The construction is 83% completed as at 31 October 2018 and is expected to commence operation by 3Q19. The last phase, which is the re-construction of a further processed plant, is ongoing and is expected to be completed by end-2020.

Mflour currently produces some 70 million birds per year. However, we understand from management that it is being constrained by limited bird slaughtering capacity. As a result, the company sells 50% of its broilers to the live bird market, which is controlled by wholesalers and where prices are more volatile. This explains, in part, the reason behind the volatile quarterly operating margin for its poultry integration segment.

**Higher capacity and meat consumption to drive growth for poultry integration**
Going forward, management indicated that it could quickly ramp up capacity to 120,000 birds per day once the construction is completed in 3Q19. Currently, Malaysians consume 53kg of chicken meat per year, equivalent to 25 broilers, and is expected to grow further. We think Mflour can easily utilize its additional capacity within 2 to 3 years, given the stronger meat consumption and higher demand from fast-food chains such as McDonald's, KFC and Kenny Roaster.

Capacity constraint also limited Mflour's ability to sell to export markets – most of its products are currently sold in the domestic market. Management has expressed intention to penetrate overseas markets such as Singapore and the Middle East by leveraging on the gold standard of Malaysia as a Halal hub. All in, we are projecting revenue of RM944 million and RM1.28 billion for FY19-20, translating into a CAGR of 35.6% due to the low-base effect in FY18.

We also believe the new primary processing plant will improve its operating margin for the coming years, conservatively estimating at 4.5% and 5% for FY19-20. This is because the company can sell more further processed products such as meatloaf, frankfurter, breaded fried chicken and nuggets (produced in the further processed plant), all of which command higher margins as compared to selling to the live bird market.

Mflour can mitigate rising costs by tweaking the feed composition should any one of the commodities – namely wheat, flour, corn and soya bean experienced a surge in price. Live bird price has recovered to above RM5 per bird from the lows of RM3.90 per bird in 3Q18.

**Expecting more earnings upside; Maintain BUY**
To recap, Mflour successfully raised RM275 million through the recent fund-raising exercise, which involved the issuance of RCULS, bonus shares and free warrants, to partly fund the expansion programme. That expanded its share base to 951.6 million shares outstanding as at 6 March 2019. We foresee limited earnings dilution in the near-term as the RCULS' conversion period is 5 years, starting from 24 January 2019.

The company has set aside some RM200 million in capital expenditure for the next two years, mainly for the reconstruction of the further processing plant, construction of an aqua feed milling plant and jetty extension. We believe the expansions will result in higher potential cost savings in the longer-term.

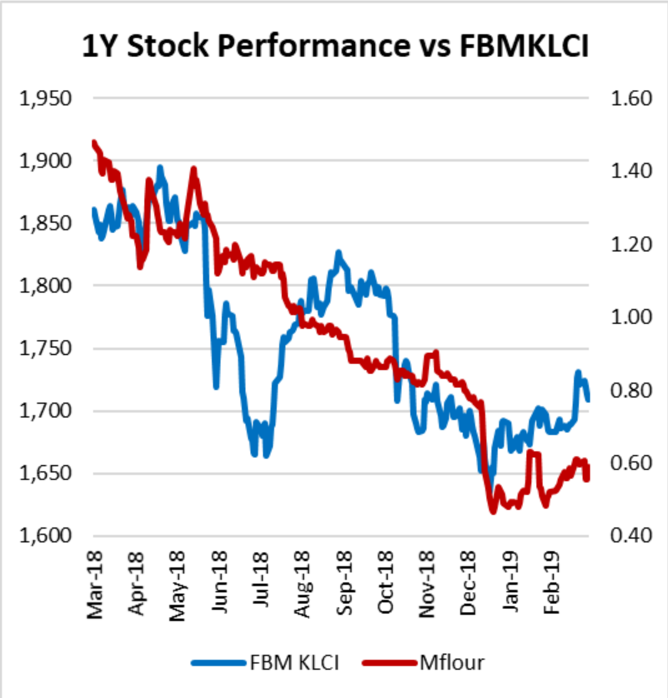
After the dismal performance in 2018, we believe Mflour is poised for a strong recovery, underpinned by volume and chicken price recovery as well as softer commodity costs. Currently, the stock is trading at attractive forward PER of 10.4 times, after the recent price rally. Assuming full conversion of RCULS and warrants, fully diluted PER stands at 12 times of FY19 estimated earnings. Looking further ahead, earnings should continue to grow at a healthy clip, supported by ramp up in bird slaughtering capacity as well as productivity and efficiency gains with the new plants.

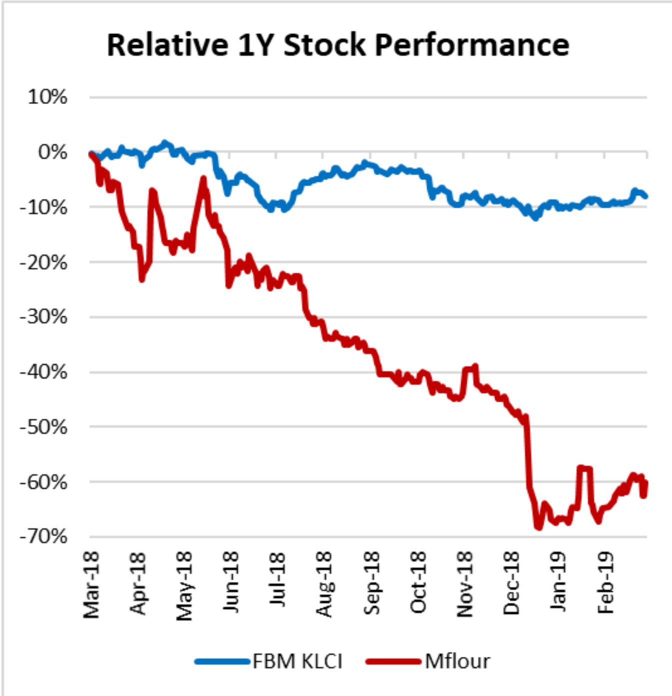
## Financial Summary

| FYE Dec 31 (RM m) | 2016A | 2017A | 2018A | 2019E | 2020E |
|---|---|---|---|---|---|
| **Income Statement** | | | | | |
| Revenue | 2,538.7 | 2,402.3 | 2,453.4 | 2,794.1 | 3,328.2 |
| Gross profit | 281.7 | 271.5 | 276.8 | 326.9 | 389.4 |
| EBIT | 115.1 | 100.7 | 65.1 | 122.0 | 135.7 |
| Core PBT | 111.3 | 96.5 | 39.9 | 99.2 | 110.0 |
| Non-recurring items | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| PBT | 111.3 | 96.5 | 39.9 | 99.2 | 110.0 |
| Tax | (18.4) | (24.5) | (12.5) | (19.8) | (22.0) |
| PATMI | 80.9 | 68.6 | 17.8 | 62.1 | 70.7 |
| Basic EPS (sen) | 15.0 | 12.5 | 3.2 | 6.5 | 7.4 |
| Diluted EPS (sen) | 15.0 | 12.5 | 3.2 | 5.7 | 6.5 |
| **Balance Sheet** | | | | | |
| FYE Dec 31 (RM m) | | | | | |
| CCE | 371.2 | 257.8 | 168.8 | 447.9 | 159.4 |
| PPE | 662.1 | 769.1 | 984.7 | 1,019.6 | 984.1 |
| Others | 1,054.7 | 1,001.0 | 1,023.0 | 1,097.0 | 1,292.1 |
| Total assets | 2,088.1 | 2,027.8 | 2,176.6 | 2,564.5 | 2,435.6 |
| ST borrowings | 933.5 | 883.1 | 975.4 | 1,025.4 | 825.4 |
| LT borrowings | 56.8 | 76.2 | 151.1 | 151.1 | 151.1 |
| Others | 180.4 | 161.2 | 156.0 | 193.9 | 236.8 |
| Total liabilities | 1,170.7 | 1,120.5 | 1,282.4 | 1,370.3 | 1,213.2 |
| Shareholders' equity | 833.1 | 834.6 | 820.5 | 1,120.4 | 1,148.7 |
| MI | 84.3 | 72.6 | 73.7 | 73.7 | 73.7 |
| Total equity | 917.4 | 907.3 | 894.2 | 1,194.2 | 1,222.4 |
| **Cash flow statement** | | | | | |
| FYE Dec 31 (RM m) | | | | | |
| CFO | 42.3 | 119.0 | 79.5 | 99.4 | 12.3 |
| Net Capex | (72.1) | (174.2) | (273.0) | (100.0) | (50.0) |
| FCF | (29.8) | (55.3) | (193.5) | (0.6) | (37.7) |
| CFI | (75.6) | (177.5) | (299.2) | (100.0) | (50.0) |
| Debt raised/(repaid) | 153.5 | 14.6 | 165.7 | 50.0 | (200.0) |
| Equity raised/(repaid) | 0.0 | 0.1 | 0.0 | 110.1 | 0.0 |
| Dividends paid | (27.5) | (35.8) | (30.3) | (37.3) | (42.4) |
| CFF | 123.1 | (27.9) | 130.2 | 279.6 | (250.7) |
| Changes in CCE | 89.8 | (86.4) | (89.5) | 279.0 | (288.4) |

| Key ratios | 2016A | 2017A | 2018A | 2019E | 2020E |
|---|---|---|---|---|---|
| **Growth (%)** | | | | | |
| Revenue | 10.3 | (5.4) | 2.1 | 13.9 | 19.1 |
| EBITDA | 39.0 | (5.4) | (20.3) | 52.5 | 18.2 |
| EBIT | 54.7 | (12.6) | (35.3) | 87.4 | 11.2 |
| Core PBT | 153.8 | (13.3) | (58.6) | 148.4 | 10.8 |
| PATMI | 293.8 | (15.2) | (74.1) | 249.4 | 13.9 |
| Tax rate | 16.5 | 25.4 | 31.2 | 20.0 | 20.0 |
| Basic EPS | 293.8 | (17.1) | (74.1) | 102.1 | 13.9 |
| Diluted EPS | 293.8 | (17.1) | (74.1) | 76.5 | 13.9 |
| **Profitability (%)** | | | | | |
| Gross margin | 11.1 | 11.3 | 11.3 | 11.7 | 11.7 |
| EBIT margin | 4.5 | 4.2 | 2.7 | 4.4 | 4.1 |
| Core PBT margin | 4.4 | 4.0 | 1.6 | 3.6 | 3.3 |
| Net Margin | 3.2 | 2.9 | 0.7 | 2.2 | 2.1 |
| ROA | 4.1 | 3.3 | 0.8 | 2.6 | 2.8 |
| ROE | 9.1 | 7.5 | 2.0 | 5.9 | 5.9 |
| Asset turnover (x) | 1.28 | 1.17 | 1.17 | 1.18 | 1.33 |
| **Liquidity** | | | | | |
| Current ratio (x) | 1.2 | 1.2 | 1.0 | 1.2 | 1.3 |
| Quick ratio (x) | 0.8 | 0.7 | 0.6 | 0.8 | 0.7 |
| **Capital Structure** | | | | | |
| Net debt (RM m) | 619.1 | 701.5 | 957.6 | 728.6 | 817.0 |
| Net gearing (%) | 80.3% | 84.2% | 114.7% | 88.8% | 72.9% |
| Interest cover (x) | 5.0 | 4.0 | 2.2 | 3.0 | 4.0 |
| **Valuations** | | | | | |
| P/E (x) | 6.7 | 12.0 | 14.9 | 10.4 | 9.2 |
| DPS (sen) | 6.5 | 6.5 | 3.0 | 3.9 | 4.5 |
| FCF yield (%) | -8.1 | -14.8 | -51.7 | -0.1 | -5.8 |
| Dvd yield (%) | 9.6 | 9.6 | 4.4 | 5.8 | 6.6 |
| NTA/share (RM) | 1.70 | 1.65 | 1.62 | 1.25 | 1.28 |
| P/B (x) | 0.4 | 0.4 | 0.4 | 0.5 | 0.5 |
| EV (RM m) | 1,165.5 | 1,237.0 | 1,487.8 | 1,569.5 | 1,700.8 |
| EV/EBITDA (x) | 7.2 | 8.0 | 12.1 | 8.4 | 7.7 |

## Price Performance




## Fundamental and Valuation Scores


*Explanatory Notes*

### Valuation Score

The score is a snapshot of the stock's attractiveness in terms of valuations calculated based on historical numbers. The score ranges from 0-3. A Valuation Score of 0 means valuations are not attractive and a score of 3 means valuations are attractive. The relative weights of the score are customisable by the user according to his preference.

### Fundamental Score

The score is a snapshot of the company's profitability and balance sheet strength derived from historical numbers. The score ranges from 0-3. A score of 0 means weak fundamentals and a score of 3 means strong fundamentals. The relative weights of the score are customisable by the user according to his preference.

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