

Earnings Review: Fraser and Neave Ltd (“FNN”)

Recommendation

- FNN delivered a decent set of results with reported 1QFY2019 EBIT higher by 42% y/y to SGD71mn, driven by outperformance from the Dairies segment (including Vinamilk) which continues to be the sole core contributor.
- Beverages (1QFY2019 segment reported EBIT: -SGD0.2mn) remains a shadow of its former self amidst intense competition. The outlook is compounded by the impending implementation of excise duty on beverages with more sugar content.
- Credit metrics remain healthy with net gearing at 10.4% and healthy cashflows from operations. We continue to hold FNN at a Neutral (4) Issuer Profile.
- We continue to Overweight both FNNSP ‘22s and FNNSP ‘27s given the healthy credit metrics and we note that FNN remains a rare issuer in the F&B space, offering diversification to investors. Investors looking for higher yields though can consider FPLSP ‘27s; we rate Frasers Property Ltd at Neutral (4) Issuer Profile.

Relative Value:

| Bond | Maturity date | Net gearing | Ask Yield | Spread |
|------------------|---------------|-------------|-----------|--------|
| FNNSP 3.09% ‘22s | 23/03/2022 | 0.10x | 3.55% | 157bps |
| FNNSP 2.8% ‘22s | 22/08/2022 | 0.10x | 3.58% | 159bps |
| FNNSP 3.8% ‘27s | 21/04/2027 | 0.10x | 4.02% | 181bps |
| BREAD 4% ‘23s | 17/01/2023 | 0.27x | 3.93% | 193bps |
| FPLSP 3.95% ‘21s | 07/10/2021 | 0.87x | 3.43% | 145bps |
| FPLSP 4.15% ‘27s | 23/02/2027 | 0.87x | 4.34% | 214bps |

Indicative prices as at 12 Feb 2019 Source: Bloomberg, OCBC, Company
Net gearing based on latest available quarter

Issuer Profile: Neutral (4)

Ticker: **FNNSP**

Background

Fraser & Neave Ltd (“FNN”) is a consumer group engaged in Food & Beverage (“F&B”) and Publishing and Printing (“P&P”) businesses. FNN is a F&B market leader in Southeast Asia, with brands including 100Plus, F&N Nutrisoy, F&N Seasons, F&N Magnolia and Farmhouse. FNN’s P&P businesses include Marshall Cavendish and Times Publishing. FNN owns 55.5% stake in Fraser & Neave Holdings Bhd (“FNNB”) and 20.01% stake in Vietnam Dairy Products (“Vinamilk”). FNN is owned by TCC Assets (59.3%) and Thai Beverage (28.5%), both linked to Charoen Sirivadhanabhakdi.

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Key Considerations

- **Essentially a milk company:** 1QFY2019 dairies revenue for the quarter ended 31 Dec remained largely unchanged y/y at SGD281mn, with FNN citing intensifying competition in canned milk in Malaysia and sweetened beverage creamer in Thailand. That said, reported EBIT for the segment surged 43.4% y/y to SGD72.0mn. This is due to (1) higher contribution from Vinamilk (+41% y/y to SGD23mn), which FNN owns a ~20.01%-stake, as well as (2) lower input costs which drove reported EBIT at Malaysia (+74% y/y to SGD15mn) and Thailand (+31% y/y to SGD32mn) higher. We note that input costs were lower due to milk-based commodities, sugar and palm oil. Dairies contribute ~100% of FNN’s reported EBIT with the other segments underperforming.
- **Beverages underperformed and outlook still uncertain:** Despite Beverages revenue rising 7.6% y/y to SGD112.6mn due to earlier sell-in for 2019 Chinese New Year, reported EBIT for the segment fell to a small negative (1QFY2018: SGD1.6mn) due to higher packaging cost and manufacturing overheads in Malaysia. Overall, competition appears to remain intense, keeping margins low. Results were also somewhat impacted by pre-operating costs incurred at the new brewery (Emerald Brewery Myanmar Ltd) in Myanmar, which FNN invested USD50mn. Outlook for Beverages segment is subdued. In addition to continuing competition, we note the implementation of 40 sen per litre of excise duty on ready-to-drink beverages that contain sugar exceeding 5g per 100ml starting 1 Apr 2019 in Malaysia. While FNN has allocated MYR30mn (~SGD10mn) in capex to create healthier products with lower sugar content, it remains to be seen if the new products will revive the business. Separately, we note that Singapore’s Ministry of Health is contemplating proposals to cut sugar intake from drinks, which can include taxes or ban on high-sugar drinks.
- **Contribution from Printing & Publishing remains non-core:** Although printing & publishing revenue amounted to SGD70.7mn, contributing 15.2% of total revenue, the segment reported EBIT is a mere SGD0.4mn (1QFY2018: SGD1.7mn). The fall in reported EBIT is due to absence of SGD1.1mn one-off

gain from the sale of machinery. FNN is looking for growth opportunities for the segment in international markets, with plans for diversification into digital print.

- **Healthy credit metrics:** Net gearing improved marginally to 10.4% (FY2018: 10.8%) mainly due to a larger equity base (+1.9% q/q to SGD3.23bn) from profits generated (SGD55.9mN) and currency translation gains (SGD5.5mn). Cash balance of SGD326.5mn well-covers short term debt which fell to SGD169.4mn (FY2018: SGD374.1mn) following the repayment of debt. We think that net gearing may inch up somewhat as FNN has stated that it will pursue new investment opportunities to grow its Beverages and Dairies segment. That said, we note that FNN has not made further substantial acquisition of stakes in Vinamilk and has utilised its large cash pile by repaying debt instead of acquisitions – we think this may signal that FNN is not intending to gear up significantly.

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Explanation of Issuer Profile Rating (“IPR”) / Issuer Profile Score (“IPS”)

Positive (“Pos”) – The issuer’s credit profile is either strong on an absolute basis, or expected to improve to a strong position over the next six months.

Neutral (“N”) – The issuer’s credit profile is fair on an absolute basis, or expected to improve / deteriorate to a fair level over the next six months.

Negative (“Neg”) – The issuer’s credit profile is either weaker or highly geared on an absolute basis, or expected to deteriorate to a weak or highly geared position over the next six months.

To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings (“IPR”) into a 7 point Issuer Profile Score (“IPS”) scale.

| IPR | Positive | | Neutral | | | Negative | |
|-----|----------|---|---------|---|---|----------|---|
| IPS | 1 | 2 | 3 | 4 | 5 | 6 | 7 |

Explanation of Bond Recommendation

Overweight (“OW”) – The performance of the issuer’s specific bond is expected to outperform the issuer’s other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Neutral (“N”) – The performance of the issuer’s specific bond is expected to perform in line with the issuer’s other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

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Other

Suspension – We may suspend our issuer rating and bond level recommendation on specific issuers from time to time when OCBC is engaged in other business activities with the issuer. Examples of such activities include acting as a joint lead manager or book runner in a new issue or as an agent in a consent solicitation exercise. We will resume our coverage once these activities are completed.

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Analyst Declaration

The analyst(s) who wrote this report and/or her or his respective connected persons did not hold financial interests in the above-mentioned issuer or company as at the time of the publication of this report.

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