Asia Credit Research

Earnings Review: Fraser and Neave Ltd ("FNN")

Recommendation

- Dairies segment (including Vinamilk) continues to be the sole core contributor, sustaining the topline which remained flattish y/y at SGD485mn.
- Despite 38.1% y/y growth in Beverages PBIT to SGD2.9mn due to reduced costs, the segment remains a shadow of its former self (e.g. FY2014's PBIT was SGD174mn). Intense competition and the introduction of sales and service tax in Malaysia may impede full recovery for this segment.
- Net gearing was largely unchanged q/q at 13.6%. However, with SGD537.4mn cash balance, we see the possibility for further acquisitions or increase in stake in Vinamilk, which may push net gearing higher. For now, credit metrics remain intact, backed by cashflows generated from operations (9MFY2018: SGD73.3mn). As such, we continue to hold FNN at a Neutral (4) Issuer Profile.
- With prices coming off, we had upgraded both FNNSP '22s and FNNSP '27s to Neutral in our August Credit View. Compared to FPLSP '21s and FPLSP '27s though, we prefer the FNNSP curve given its far healthier credit metrics while spreads are about 10-15bps lower. We note that FNN remains a rare issuer in the F&B space, offering diversification to investors.

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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Relative Value:

Bond	Maturity date	Net gearing	Ask Yield	Spread
FNNSP 3.09% '22s	23/03/2022	0.14x	3.31%	119bps
FNNSP 2.8% '22s	22/08/2022	0.14x	3.26%	110bps
FNNSP 3.8% '27s	21/04/2027	0.14x	4.03%	158bps
BREAD 4% '23s	17/01/2023	0.29x	3.91%	173bps
FPLSP 3.95% '21s	07/10/2021	0.91x	3.36%	127bps
FPLSP 4.15% '27s	23/02/2027	0.91x	4.17%	172bps

Indicative prices as at 15 Aug 2018 Source: Bloomberg, OCBC, Company
Net gearing based on latest available quarter

Key Considerations

- **Dairies (including Vinamilk) as the core profit contributor:** FNN reported 3QFY2018 results for the quarter ending 30 June. Revenue continues to remain flattish (+0.4% y/y to SGD485.0mn) as FNN continues to run only on one engine – Dairies. Dairies revenue increased 5.2% y/y to SGD290.4mn as a result of higher export sales and favourable currency movements at Malaysia while Thailand Dairies also contributed more due to growth in export sales. Excluding Vinamilk, we estimate that Dairies contribution increased ~38% y/y to SGD34mn. Meanwhile, share of associated companies' profit (mostly Vinamilk) increased 81.3% y/y to SGD39.6mn. As such, Dairies and Vinamilk were the key contributors to PBIT before exceptional items of SGD68.4mn. However, this represented a decline of 5.2% y/y as FNN recorded only share of profits from Vinamilk and not dividend income (3QFY2017: SGD33.4mn) due to its reclassification as an associate in 3QFY2017. Comparatively, 3QFY2017 recorded both dividend income and share of profits from Vinamilk.

- **Improved profitability at Beverages but still a shadow of its former self:** Beverages reported PBIT surged y/y to SGD2.9mn (3QFY2017: SGD2.1mn) due to favourable sugar cost and currency movements though this segment's contribution remains a shadow of its former self (as an example, FY2014's PBIT for this segment was SGD174mn). We see a number of challenges impeding the full recovery of the Beverages segment as competition remains keen. Another challenge, albeit smaller in our view, will be the impact from the introduction of sales and service tax that replaces the GST in Malaysia. Thus far in 3QFY2018, revenue fell for the Beverages segment (-5.4% y/y to SGD133.8mn) due to the soft market sentiments and consumers postponing purchases as a result of changes in GST regulations and weaker sales to Indonesia due to the depreciation of the IDR.

- **Credit metrics remain healthy, for now:** Net gearing increased marginally to 13.6% q/q (2QFY2018: 13.3%) despite generating net cash of SGD28.2mn from operations due to further purchase (SGD9.4mn) of stake in associated company (likely due to Vinamilk) as well as SGD36.5mn in total payments in dividends by FNN and its subsidiaries to non-controlling interests. With SGD537.4mn cash on hand, liquidity remains ample though we think this may eventually be used for acquisitions or further purchase in stakes in Vinamilk (current stake: 20.01%) – which may push gearing higher (gearing policy: up to 80%). For now, the credit metrics remain healthy, with good cashflows generated from the Dairies segment and dividends upstreamed from Vinamilk.

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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.

Underweight (“UW”) – The performance of the issuer’s specific bond is expected to underperform 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.

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.

Withdrawal (“WD”) – We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

Analyst Declaration

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

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