OCBC Bank

Issuer Profile:
Neutral (4)

Ticker:
FNNSP

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Fraser and Neave Ltd ("FNN")

Recommendation

- **Results improved across all major segments of FNN (other than Vinamilk). Aside from revenue growth (+6.7% y/y to SGD489.7mn) driven by successful campaigns, profit margins expanded with PBIT higher by 25.6% y/y to SGD91.0mn from lower input costs.**
- **We think that the improvement in results may not necessarily sustain through FY2020 as input costs have moved higher, though FNN has hedged such costs for 4QFY2019.**
- **Credit metrics still look healthy despite net gearing reaching 15.2% (2QFY2019: 10.6%). This is due to acquisitions (e.g. stakes in Starbucks Thailand, Genki Sushi Thailand). Meanwhile, FNN remains cash generative with sufficient liquidity.**
- **We think FNNSP curve still looks somewhat interesting given its healthy credit metrics. For investors seeking higher yields, METRO 4.3% 2024s can be considered which we similarly rate with an Issuer Profile of Neutral (4).**

Relative Value:

Bond	Maturity / Call date	Net gearing	Ask YTW	Spread
FNNSP 3.09% 2022	23/03/2022	15%	2.78%	123bps
FNNSP 2.80% 2022	22/08/2022	15%	2.91%	137bps
FNNSP 3.80% 2027	21/04/2027	15%	3.44%	192bps
BREAD 4% 2023	17/01/2023	65%	3.72%	219bps
METRO 4.3% 2024	02/04/2024	8%	3.71%	220bps

Indicative prices as at 15 August 2019 Source: Bloomberg
Aggregate leverage based on latest available quarter

Background

- Listed on SGX with a market cap of SGD2.5bn, Fraser and Neave Ltd ("FNN") is a consumer group primarily engaged in Food & Beverage ("F&B").
- FNN is an F&B market leader in Southeast Asia, with brands including 100Plus, F&N Nutrisoy, F&N Seasons, F&N Magnolia and Farmhouse. FNN also owns a Publishing and Printing ("P&P") business ("P&P"), which include Marshall Cavendish and Times Publishing.
- FNN owns 55.5% stake in Fraser & Neave Holdings Bhd and ~20% stake in Vietnam Dairy Products JSC ("Vinamilk"). FNN is owned by TCC Assets Ltd (59.2%) and Thai Beverage (28.5%), both linked to Thai billionaire Mr Charoen.

Key Considerations

- **Significantly better results from all segments…:** FNN reported 3QFY2019 results. Revenue rose 6.7% y/y to SGD489.7mn, led by increase in Beverages (+11.6% y/y to SGD133.0mn), Dairies (+5.5% y/y to SGD294.3mn) and P&P (+2.6% y/y to SGD62.3mn). Correspondingly, PBIT rose 25.6% y/y to SGD91.0mn, contributed by P&P which turned to positive SGD9.4mn (3QFY2018: negative SGD4.7mn), Beverages increasing to SGD6.7mn (3QFY2018: SGD2.9mn) and Dairies (+4.8% y/y to SGD77.2mn). The only segment which underperformed is Vinamilk; we estimate that its contribution has fallen to SGD31.2mn (3QFY2018: SGD38.4mn).

- **… with stronger profits driven mainly by lower costs:** The expansion in PBIT margin for Beverages to 5.0% (3QFY2018: 2.4%) is likely driven by lower cost, noting lower sugar cost and lower marketing spend. Similarly for Dairies (ex Vinamilk), a large part of the PBIT margin growth to an estimated 15.6% (3QFY2018: 12.6%) is due to lower input costs. For revenue growth in the Beverages segment, this was mainly due to successful festive campaigns for Hari Raya and successful introduction of new healthier products. Again similar to Beverages, revenue growth in Dairies is due to successful loyalty programs and campaigns. For the P&P segment, most of the improvements in profitability is due to one-off income from the sale of non-core assets; the good performance for the segment is not expected to be repeated.

- **Challenges remain ahead that may impede sustainability of growth:** Firstly, we think effects from lower commodity prices and marketing costs which helped boost results may not remain indefinitely though FNN may continue to benefit from low input costs through 4QFY2019 as input costs has been hedged. We note that input costs (e.g. skimmed milk powder) prices have been increasing, which should impact input costs in FY2020. For the Beverages segment, the implementation of excise duty on sugar sweetened beverages in Malaysia is a potential headwind, though management flagged that not much impact has been seen yet. In addition, Malaysia market may remain challenging due to intense competition, noting that 9MFY2019 reported PBIT has already fallen 7.7% for the segment.

- **Still healthy credit metrics despite acquisitions made:** Net gearing climbed q/q to 15.2% (2Q2019: 10.6%), which looks healthy still. The increase is mainly due to cash outflow from the acquisition of StarBucks Thailand (through a joint venture with Maxim's Caterers Ltd), which resulted in FNN making SGD114.8mn capital injection. Meanwhile, FNN also made acquisitions of 20.75%-stake in Genki Sushi Thailand and 60%-stake in Print Lab. Separately, we note that FNN has already (for some time) stopped acquiring more stakes in Vinamilk. Cash of SGD212.2mn well covers borrowings of SGD192.6mn due within 12 months. In addition, FNN holds another SGD95.8mn in bank fixed deposits. Credit profile remains intact with healthy operating cash before working capital changes of SGD64.2mn (3QFY2018: SGD48.4mn).

Explanation of Issuer Profile Rating / Issuer Profile Score

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 into a 7 point Issuer Profile Score scale.

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

Please note that Bond Recommendations are dependent on a bond's price, underlying risk free rates and an implied credit spread that reflects the strength of the issuer's credit profile. Bond Recommendations may not be relied upon if one or more of these factors change.

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.

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