

Farm Fresh Berhad (FFB MK)

Emerging from the clouds

Maintain BUY with unchanged TP of MYR1.75

FFB's outlook prospects are positive. With operating expenses under control and production constraints behind them, the group is poised for growth from 2HFY23 onwards. We keep our earnings estimates unchanged. Reiterate BUY with a TP of MYR1.75 (29x CY23E PER based on the Malaysia dairy-related peer average).

Production constraints to be alleviated by Feb 2023

FFB has recently received new equipment required for its additional capacity line to be installed at its Muadzam Shah facility. Its Taiping processing plant is also on-track to be commissioned by early-Feb 2023 with a total annual production capacity of 21m Litres of milk. With new capacity coming onstream, FFB will not only be able to cater to rising demand for its existing and new products, it will also have the capabilities to tender for more regions under the Government school milk program when its current contract ends in Feb 2023. FFB currently supplies milk to schools in the North, East and Southern regions of Malaysia.

Growing sales in all channels

Heavy inroads are being made to grow its presence in the HORECA channel. On top of its existing milk supply contracts with domestic *Starbucks* and *Coffee Bean* chains, FFB will begin supplying its milk products to hotels (*i.e. Shangri-La*) by end-Jan 2023. It is also in the process of securing a milk supply contract with a large F&B chain in 4QFY23. Sales for their recently launched kids growing-up-milk (GUM) and Yarra by Farm Fresh (UHT) in Oct and Nov 2022 respectively have been meeting internal targets and their contribution will continue rising with their introduction in more sales channels going forward.

Expecting better 2HFY23 earnings HoH

FFB's 2HFY23 operating margins are expected to improve HoH on the back of weaker whole milk powder ASPs by c.8% QoQ (Fig. 1), and the full effect of its chilled product price increase (+5%, effective Aug 2022). In the medium-term, strong drivers in earnings growth will come from capacity growth from the completion of its Philippines processing plant (target: end-May 2023) and Bandar Enstek manufacturing plant (target: 1HFY25). On the heels of a successful launch of its GUM, FFB is also planning to create a fortified milk powder product for kids within the next 6 months to gain further traction into the fortified milk market.

FYE Mar (MYR m)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	490	502	609	788	946
EBITDA	99	104	124	191	213
Core net profit	80	82	77	121	139
Core EPS (sen)	4.3	4.4	4.2	6.5	7.5
Core EPS growth (%)	127.2	2.2	(5.4)	57.0	14.1
Net DPS (sen)	0.0	1.1	1.0	1.6	1.9
Core P/E (x)	na	37.2	38.9	24.8	21.7
P/BV (x)	na	5.0	4.5	4.0	3.5
Net dividend yield (%)	na	0.7	0.6	1.0	1.2
ROAE (%)	17.1	19.0	12.2	17.1	17.2
ROAA (%)	15.5	10.0	6.9	9.4	9.8
EV/EBITDA (x)	32.9	31.8	27.5	18.0	16.0
Net gearing (%) (incl perps)	95.5	42.0	60.3	55.3	48.1
Consensus net profit	-	-	75	104	125
MKE vs. Consensus (%)	-	-	3.8	17.3	10.9

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BUY

Share Price	MYR 1.62
12m Price Target	MYR 1.75 (+10%)
Previous Price Target	MYR 1.75

Company Description

Farm Fresh Berhad is principally involved in rearing of dairy cows and goats, and the production, marketing and sale of dairy consumer products.

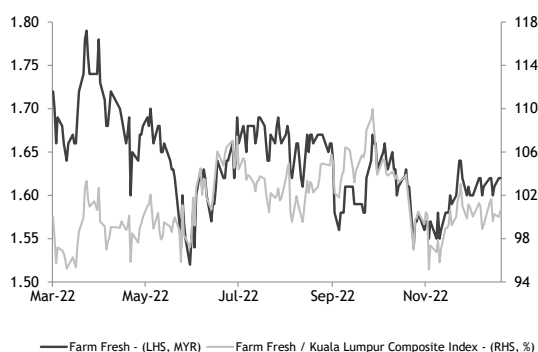
Statistics

52w high/low (MYR)	na/na
3m avg turnover (USDm)	0.6
Free float (%)	38.3
Issued shares (m)	1,858
Market capitalisation	MYR3.0B USD688M

Major shareholders:

Rainforest Capital	30.7%
Farmchoice Foods	13.8%
AgriFood Resources	11.8%

Price Performance



	-1M	-3M	-12M
Absolute (%)	2	2	na
Relative to index (%)	1	(4)	na

Source: FactSet

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Risk Rating & Score ¹	NA
Score Momentum ²	NA
Last Updated	NA
Controversy Score ³	NA

Business Model & Industry Issues

- A large part of global GHG emissions come from the agriculture industry, including dairy farming. Hence, FFB has implemented various measures to identify and monitor its emissions group-wide while reducing overall carbon footprint through higher usages of renewable energy sources and increasing circularity of farming.
- Producing healthy dairy products has been FFB’s core mission since the company was founded. To this end, the group prides itself on offering a product portfolio free from preservatives, unnatural colourings, and other foreign substances.
- FFB’s ESG measures are comparable to its industry peers with strict guidelines to address environmental, animal cruelty and product safety and quality concerns.

Material E issues

- Main emission sources arise from methane from enteric fermentation, nitrous oxide from fertilisers, carbon dioxide from tillage and the burning of fossil fuels to power its farms and facilities.
- FFB targets to achieve 25% reduction in its group-wide GHG emissions over 5 years from 2021 through adoption of renewable energy (eg. biogas plant, solar panels).
- It also strives to remove its dependency on chemical fertilisers and instead use waste generated by their herd for pasture irrigation, compost bedding and organic fertilisers.
- Farms adhere to the group’s good animal husbandry practices, which sets out strict practises in animal health care, nutrition, and housing. This code was developed in line with the Malaysian Good Agricultural Practices and the World Organisation for animal health’s guidelines.
- All completed Malaysian farms have received the certified humane accreditation.

Material S issues

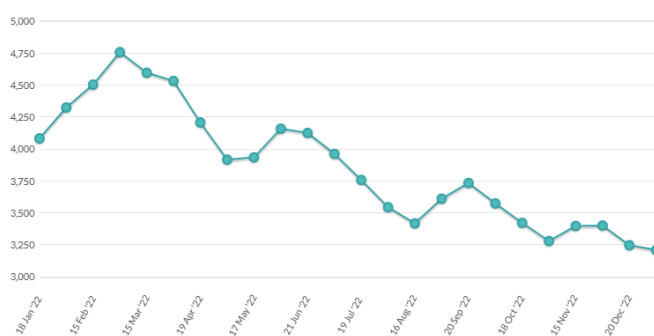
- 72% of its total workforce are recruited from rural and underserved communities.
- FFB has ensured that 100% of its processing facilities across Malaysia and Australia are operated according to relevant food safety and quality principles.
- No major product recalls due to safety reasons since 2014.
- 100% of products meet endorsed nutritional guidelines. All products are free from preservatives, artificial colourings, and flavourings.
- 18.8% of its portfolio of products comprise alternative milk products to cater a wide range of consumer dietary requirements.
- Distributed 6.2m packets of milk to 206k students across c.3k schools under the *Rancangan Makanan Tambahan* supplementary food programmes.

Key G metrics and issues

- In FY22, FFB’s board comprised of 7 directors, the majority of whom are independent directors - 4 independent non-executive directors, 2 non-independent non-executive directors, and the group managing director and CEO who is an executive director.
- The chairman of the board and the CEO are held by separate individuals.
- 2 out of 7 members of the Board are held by women, representing 29% female representation. This is below the 30% threshold recommended by the Malaysian Code on Corporate Governance.
- The group has yet to form a company policy on gender diversity for the board and senior management. It plans to formalise and approve the relevant policy within the next year.
- The audit committee comprises solely of independent non-executive directors.
- The group has detailed disclosure on a named basis for the remuneration component (incl. salary, bonus, benefits-in-kind and other emoluments) of individual directors and its top 5 senior management in bands of MYR50k.
- FFB’s auditor is KPMG PLT.
- The group CEO’s remuneration package of MYR1.6m represents 2% of the group’s reported pre-tax profit in FY22.
- The majority of FFB’s related party transactions involve transactions for its normal day-to-day operations including the purchases and sales of raw milk, finished goods, biological assets and property, plant and equipment.

¹**Risk Rating & Score** - derived by Sustainalytics and assesses the company’s exposure to unmanaged ESG risks. Scores range between 0 - 50 in order of increasing severity with low/high scores & ratings representing negligible/significant risk to the company’s enterprise value, respectively, from ESG-driven financial impacts. ²**Score Momentum** - indicates changes to the company’s score since the last update - a **negative** integer indicates a company’s improving risk score; a **positive** integer indicates a deterioration. ³**Controversy Score** - reported periodically by Sustainalytics in the event of material ESG-related incident(s), with the impact severity scores of these events ranging from Category 0-5 (0 - no reports; 1 - negligible risks; ...; 5 - poses serious risks & indicative of potential structural deficiencies at the company).

Fig 1: Whole milk powder ASP trend (USD/MT)



Source: Global Dairy Trade, Company

Fig 2: Malaysia dairy-related beverage sector peer comparison

Stock	Shr px (Local)	Mkt cap (MYRm)	PER (x) CY23F	PER (x) CY24F	P/B (x) CY23F	P/B (x) CY24F	EV/EBITDA (x) CY23F	EV/EBITDA (x) CY24F	ROAE (%) CY23F	ROAE (%) CY24F	Yield (%) CY23F
Nestle Malaysia [^]	137.50	32,244	40.8	38.4	54.7	54.4	25.5	24.4	134.6	142.0	2.4
F&N Holdings	22.14	7,702	18.9	17.5	2.5	2.3	11.7	10.9	14.0	12.9	2.9
Dutch Lady Milk	29.80	1,984	20.2	19.4	3.9	n.m.	10.8	n.m.	17.1	10.7	1.9
Simple average			26.6	25.1	20.4	28.4	16.0	17.6	55.2	55.2	2.4

*As at 10 Jan 2023 closing prices

Source: Bloomberg, Maybank IBG Research

[^] Nestle Malaysia is based on Maybank IBG Research estimates

Risk statement

There are several risk factors for our earnings estimates, price target, and rating for FFB. Unfavourable spikes in raw milk and dairy cattle feed costs could adversely affect earnings. Dairy cows are also vulnerable to disease and epidemic outbreaks that could lead to demand-supply imbalances.

FYE 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
Key Metrics					
P/E (reported) (x)	na	39.0	38.9	24.8	21.7
Core P/E (x)	na	37.2	38.9	24.8	21.7
P/BV (x)	na	5.0	4.5	4.0	3.5
P/NTA (x)	na	5.2	4.7	4.1	3.6
Net dividend yield (%)	na	0.7	0.6	1.0	1.2
FCF yield (%)	na	nm	nm	1.6	2.4
EV/EBITDA (x)	32.9	31.8	27.5	18.0	16.0
EV/EBIT (x)	42.0	43.8	37.7	24.0	21.2
INCOME STATEMENT (MYR m)					
Revenue	490.5	501.9	609.0	788.1	946.5
EBITDA	98.8	104.1	124.1	191.0	213.5
Depreciation	(21.2)	(28.3)	(33.1)	(47.8)	(51.9)
Amortisation	(0.2)	(0.2)	(0.2)	(0.2)	(0.2)
EBIT	77.3	75.5	90.7	142.9	161.3
Net interest income / (exp)	(9.8)	(9.8)	(8.6)	(13.3)	(13.7)
Associates & JV	0.0	0.0	0.0	0.0	0.0
Exceptionals	(43.8)	(1.9)	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	67.6	65.7	82.1	129.6	147.6
Income tax	(34.8)	12.9	(6.1)	(9.5)	(10.3)
Minorities	3.4	1.3	1.3	1.3	1.3
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	36.2	79.9	77.4	121.5	138.6
Core net profit	80.0	81.8	77.4	121.5	138.6
BALANCE SHEET (MYR m)					
Cash & Short Term Investments	11.7	28.1	32.0	16.0	20.7
Accounts receivable	88.8	100.2	122.5	158.6	190.4
Inventory	105.0	118.8	142.5	179.7	218.3
Property, Plant & Equip (net)	307.1	339.6	498.0	541.6	581.2
Intangible assets	19.9	20.0	19.8	19.5	19.3
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	89.7	403.2	420.5	438.7	457.1
Total assets	622.3	1,010.0	1,235.2	1,354.2	1,487.0
ST interest bearing debt	140.9	52.3	52.3	52.3	52.3
Accounts payable	83.1	93.1	111.6	140.7	170.9
LT interest bearing debt	101.0	232.3	382.3	382.3	382.3
Other liabilities	56.0	21.0	21.0	21.0	21.0
Total Liabilities	381.2	399.1	567.5	596.7	626.9
Shareholders Equity	234.6	605.9	664.0	755.1	859.0
Minority Interest	6.4	5.0	3.7	2.4	1.1
Total shareholder equity	241.0	611.0	667.7	757.5	860.1
Total liabilities and equity	622.3	1,010.0	1,235.2	1,354.2	1,487.0
CASH FLOW (MYR m)					
Pretax profit	67.6	65.7	82.1	129.6	147.6
Depreciation & amortisation	21.4	28.6	33.3	48.1	52.1
Adj net interest (income)/exp	0.0	0.0	0.0	0.0	0.0
Change in working capital	(40.0)	(15.4)	(26.7)	(44.1)	(40.2)
Cash taxes paid	(0.1)	(29.7)	(6.1)	(9.5)	(10.3)
Other operating cash flow	0.7	(11.0)	(1.0)	(1.1)	(1.3)
Cash flow from operations	59.7	49.2	91.2	137.2	162.1
Capex	(74.0)	(59.2)	(190.0)	(90.0)	(90.0)
Free cash flow	(14.4)	(10.0)	(98.8)	47.2	72.1
Dividends paid	0.0	0.0	(19.3)	(30.4)	(34.6)
Equity raised / (purchased)	0.4	292.8	0.0	0.0	0.0
Change in Debt	31.5	88.9	150.0	0.0	0.0
Other invest/financing cash flow	(19.0)	(340.8)	(28.0)	(32.8)	(32.8)
Effect of exch rate changes	(0.6)	(0.2)	0.0	0.0	0.0
Net cash flow	(2.1)	30.7	3.9	(15.9)	4.6

FYE 31 Mar	FY21A	FY22A	FY23E	FY24E	FY25E
Key Ratios					
Growth ratios (%)					
Revenue growth	61.8	2.3	21.3	29.4	20.1
EBITDA growth	74.6	5.4	19.2	54.0	11.8
EBIT growth	81.5	(2.4)	20.1	57.5	12.9
Pretax growth	86.8	(2.8)	25.0	57.8	13.8
Reported net profit growth	2.9	120.5	(3.1)	57.0	14.1
Core net profit growth	127.2	2.2	(5.4)	57.0	14.1
Profitability ratios (%)					
EBITDA margin	20.1	20.7	20.4	24.2	22.6
EBIT margin	15.8	15.0	14.9	18.1	17.0
Pretax profit margin	13.8	13.1	13.5	16.5	15.6
Payout ratio	0.0	25.0	25.0	25.0	25.0
DuPont analysis					
Net profit margin (%)	7.4	15.9	12.7	15.4	14.6
Revenue/Assets (x)	0.8	0.5	0.5	0.6	0.6
Assets/Equity (x)	2.7	1.7	1.9	1.8	1.7
ROAE (%)	17.1	19.0	12.2	17.1	17.2
ROAA (%)	15.5	10.0	6.9	9.4	9.8
Liquidity & Efficiency					
Cash conversion cycle	68.5	91.3	89.1	87.0	89.5
Days receivable outstanding	62.3	67.8	65.8	64.2	66.4
Days inventory outstanding	74.8	110.2	107.3	104.9	106.7
Days payables outstanding	68.5	86.7	84.1	82.2	83.6
Dividend cover (x)	nm	4.0	4.0	4.0	4.0
Current ratio (x)	0.8	3.6	3.5	3.3	3.2
Leverage & Expense Analysis					
Asset/Liability (x)	1.6	2.5	2.2	2.3	2.4
Net gearing (%) (incl perps)	95.5	42.0	60.3	55.3	48.1
Net gearing (%) (excl. perps)	95.5	42.0	60.3	55.3	48.1
Net interest cover (x)	7.9	7.7	10.6	10.8	11.7
Debt/EBITDA (x)	2.4	2.7	3.5	2.3	2.0
Capex/revenue (%)	15.1	11.8	31.2	11.4	9.5
Net debt/ (net cash)	230.2	256.5	402.7	418.6	413.9

Source: Company; Maybank IBG Research

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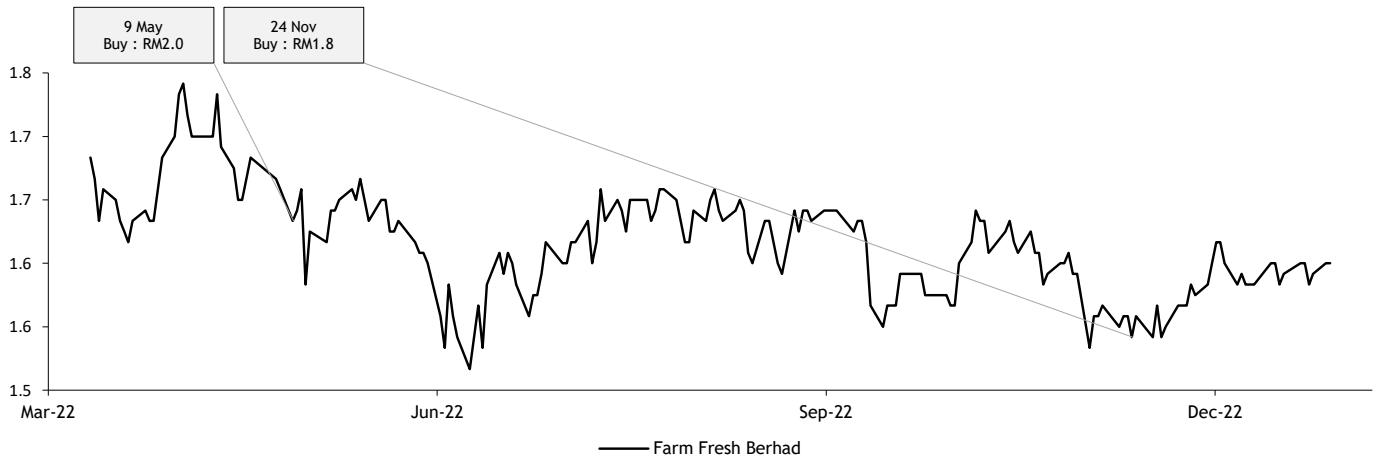
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Historical recommendations and target price: Farm Fresh Berhad (FFB MK)



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