

# Farm Fresh Berhad (FFB MK)

## A tale of two halves

### TP lowered to MYR1.20, maintain HOLD

Cost challenges are expected to persist in the near term but stable product demand, product price hikes and softening raw material costs in 2HFY24 should drive stronger earnings HoH. We lower FY24E-FY25E earnings estimates by 11%-21% but leave FY26E unchanged. Pegging the stock to the consumer sector CY24 PER of 24x, our TP is revised to MYR1.20 (-40sen, vs. 26x CY24E previously).

### Lower-than-expected raw milk savings

Despite FFB's expectations for a 10%-14% retracement in Australian farmgate ASPs for the 2023/2024 (1 Jul 2023 to 30 Jun 2024) milk season, management confirmed that ASPs have only fallen c.4% (to AUD9.74/kg of milk solids) against 1HFY23 ASP of MYR10.12/kg of milk solids). We believe that the ASP variance was largely from a demand surge, exacerbated by lower milk output on prolonged drought and labour shortages in Australia.

### Increasing internal milk source to offset cost pressure

To mitigate ongoing elevated farmgate ASPs, FFB aims to lower its reliance on raw milk from third party farmers by lifting its upstream milk output and increasing its internal:external milk sourcing ratio to 69:31 in FY24 (from 48:51 in FY23). Easing whole milk powder (WMP) ASPs (Fig. 1) also offers an additional avenue of earnings support once the group rolls over into a lower inventory cost cycle. FFB has hedged its WMP ASPs at c.USD3,240/MT from Jun until Oct 2023 which reflects c.15% in cost savings against its existing average WMP ASP of USD3,800/MT. Note that WMP is estimated to account for 49% of its total milk requirement in FY24E (from 38% in FY23).

### Long term prospects are intact

Reflecting FFB's current raw material cost structure, we adjust our FY24E/FY25E earnings estimate by -21%/-11% but leave FY26E unchanged. We expect FFB's 1HFY24 earnings to be weak, with the bulk of WMP cost savings coming through in 2HFY24. FFB's new product pipeline and regional expansion into the Philippines is on track as it targets to commission its processing plant in Aug 2023. The group plans to launch its powdered growing up milk variant in Oct 2023 and introduce its ice cream product for the domestic consumer-packaged goods segment in Jan 2024.

FYE Mar (MYR m)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue	502	630	788	956	1,104
EBITDA	104	97	131	182	219
Core net profit	82	50	65	107	136
Core FDEPS (sen)	4.4	2.7	3.5	5.7	7.3
Core FDEPS growth(%)	2.2	(38.9)	30.8	63.2	27.6
Net DPS (sen)	1.1	0.7	0.9	1.4	1.8
Core FD P/E (x)	37.2	55.8	31.3	19.2	15.0
P/BV (x)	5.0	4.4	3.0	2.7	2.4
Net dividend yield (%)	0.7	0.4	0.8	1.3	1.7
ROAE (%)	19.0	8.1	10.0	14.8	16.8
ROAA (%)	10.0	4.8	5.7	8.2	9.5
EV/EBITDA (x)	31.8	32.0	18.8	13.8	11.5
Net gearing (%) (incl perps)	42.0	49.3	58.9	59.6	55.0
Consensus net profit	-	-	83	112	129
MIBG vs. Consensus (%)	-	-	(20.6)	(4.3)	5.5

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# HOLD

Share Price	MYR 1.10
12m Price Target	MYR 1.20 (+10%)
Previous Price Target	MYR 1.60

### 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.

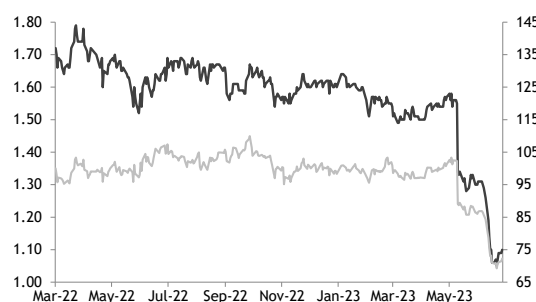
### Statistics

52w high/low (MYR)	1.69/1.05
3m avg turnover (USDm)	1.3
Free float (%)	37.1
Issued shares (m)	1,858
Market capitalisation	MYR2.0B USD450M

### Major shareholders:

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

### Price Performance



— Farm Fresh - (LHS, MYR) — Farm Fresh / Kuala Lumpur Composite Index - (RHS, %)

	-1M	-3M	-12M
Absolute (%)	(15)	(27)	(32)
Relative to index (%)	(16)	(26)	(31)

Source: FactSet

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Risk Rating & Score <sup>1</sup>	NA
Score Momentum <sup>2</sup>	NA
Last Updated	NA
Controversy Score <sup>3</sup>	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

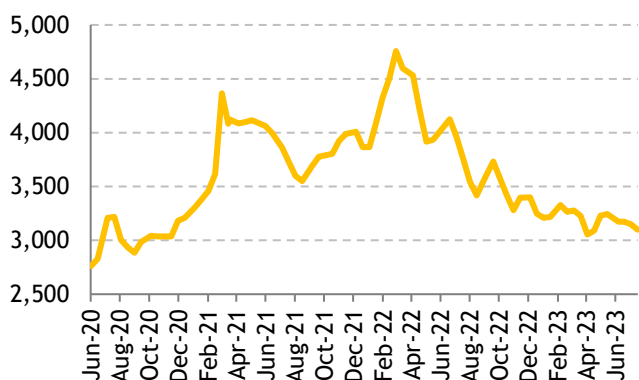
- 72% of its total workforce are recruited from rural and underserved communities.
- FFB has ensured that 100% of its processing facilities across Malaysia and Australia are operated according to relevant food safety and quality principles.
- No major product recalls due to safety reasons since 2014.
- 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.

<sup>1</sup>**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. <sup>2</sup>**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. <sup>3</sup>**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 average ASP (USD/MT)



Source: Global Dairy Trade, Company

Fig 2: Consumer sector - Peer valuation summary

Stock	Rec	Shr px (MYR)	Mkt cap (MYR m)	TP (MYR)	PER (x) CY22A	PER (x) CY23E	PER (x) CY24E	PBV (x) CY23E	PBV (x) CY24E	ROE (%) CY23E	ROE (%) CY24E	Net yield (%) CY23E
AEON Co. (M)	Buy	1.22	1,713	2.00	12.8	12.2	11.7	0.9	0.9	7.4	7.4	3.3
Carlsberg Brewery M'sia	Buy	20.68	6,323	24.70	19.4	18.3	17.5	29.4	22.6	164.9	131.3	4.5
Heineken M'sia	Buy	26.66	8,054	30.80	19.5	18.8	18.4	16.5	16.5	85.7	85.9	5.3
Padini Holdings	Buy	3.93	2,586	5.20	14.1	11.8	11.4	2.3	2.0	19.5	17.6	2.5
Nestle (Malaysia)	Sell	131.40	30,813	118.80	46.5	44.8	39.8	48.7	48.1	108.8	121.0	2.2
QL Resources	Hold	5.32	12,947	5.90	41.1	33.0	30.4	4.5	4.0	13.8	13.5	0.8
7 - Eleven M'sia Hldgs	Hold	2.01	2,355	1.90	32.4	29.6	26.8	13.6	11.4	46.1	42.6	2.1
Mynews Holdings	Hold	0.47	353	0.51	n.a.	n.a.	80.0	1.5	1.5	(6.4)	1.5	0.0
Berjaya Food	Buy	0.70	1,373	0.72	11.1	12.8	12.3	2.3	2.0	17.7	16.6	3.9
Leong Hup Intl.	Sell	0.52	1,880	0.50	8.7	19.3	12.1	0.9	0.9	4.7	7.2	1.5
MR D.I.Y. Group (M)	Buy	1.48	13,963	2.40	29.0	24.3	20.3	8.0	6.7	33.2	32.8	2.0
InNature	Buy	0.56	395	0.61	18.7	18.7	16.5	2.4	2.1	14.4	15.9	5.4
Farm Fresh	Hold	1.10	2,059	1.20	35.2	33.2	21.2	3.1	2.8	9.2	13.0	0.8
<b>Simple average</b>					<b>24.0</b>	<b>23.1</b>	<b>24.4</b>	<b>10.3</b>	<b>9.3</b>	<b>39.9</b>	<b>39.0</b>	<b>2.6</b>

Source: Bloomberg, Maybank IBG Research

## 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	FY22A	FY23A	FY24E	FY25E	FY26E
<b>Key Metrics</b>					
P/E (reported) (x)	39.0	60.2	31.2	19.1	15.0
Core P/E (x)	37.2	55.7	31.2	19.1	15.0
Core FD P/E (x)	37.2	55.8	31.3	19.2	15.0
P/BV (x)	5.0	4.4	3.0	2.7	2.4
P/NTA (x)	5.2	4.6	3.1	2.8	2.4
Net dividend yield (%)	0.7	0.4	0.8	1.3	1.7
FCF yield (%)	nm	nm	nm	1.0	2.9
EV/EBITDA (x)	31.8	32.0	18.8	13.8	11.5
EV/EBIT (x)	43.8	48.8	28.3	18.8	15.2

**INCOME STATEMENT (MYR m)**

Revenue	501.9	629.7	788.1	955.6	1,103.6
EBITDA	104.1	97.1	130.7	181.7	218.8
Depreciation	(28.3)	(33.0)	(43.5)	(48.3)	(52.7)
Amortisation	(0.2)	(0.5)	(0.5)	(0.5)	(0.5)
EBIT	75.5	63.6	86.7	132.9	165.7
Net interest income / (exp)	(9.8)	(11.5)	(16.2)	(18.1)	(19.2)
Associates & JV	0.0	0.0	0.0	0.0	0.0
Exceptionals	(1.9)	0.0	0.0	0.0	0.0
Other pretax income	0.0	0.0	0.0	0.0	0.0
Pretax profit	65.7	52.2	70.5	114.7	146.5
Income tax	12.9	(2.2)	(5.1)	(8.0)	(10.3)
Minorities	1.3	0.1	0.1	0.1	0.1
Discontinued operations	0.0	0.0	0.0	0.0	0.0
Reported net profit	79.9	50.1	65.5	106.8	136.4
Core net profit	81.8	50.1	65.5	106.8	136.4

**BALANCE SHEET (MYR m)**

Cash & Short Term Investments	28.1	23.0	32.8	30.7	9.4
Accounts receivable	100.2	131.8	165.9	201.2	232.4
Inventory	118.8	173.7	216.8	254.6	290.9
Property, Plant & Equip (net)	339.6	413.9	463.0	507.4	547.3
Intangible assets	20.0	19.3	18.8	18.4	17.9
Investment in Associates & JVs	0.0	0.0	0.0	0.0	0.0
Other assets	403.2	301.8	331.0	360.0	389.9
<b>Total assets</b>	<b>1,010.0</b>	<b>1,063.5</b>	<b>1,228.4</b>	<b>1,372.3</b>	<b>1,487.8</b>
ST interest bearing debt	52.3	92.9	92.9	92.9	92.9
Accounts payable	93.1	64.0	79.9	93.8	107.2
LT interest bearing debt	232.3	243.3	343.3	393.3	393.3
Other liabilities	21.0	27.0	27.0	27.0	27.0
<b>Total Liabilities</b>	<b>399.1</b>	<b>427.6</b>	<b>543.5</b>	<b>607.4</b>	<b>620.8</b>
Shareholders Equity	605.9	631.0	680.1	760.3	862.5
Minority Interest	5.0	4.9	4.8	4.6	4.5
<b>Total shareholder equity</b>	<b>611.0</b>	<b>635.9</b>	<b>684.9</b>	<b>764.9</b>	<b>867.0</b>
<b>Total liabilities and equity</b>	<b>1,010.0</b>	<b>1,063.5</b>	<b>1,228.4</b>	<b>1,372.3</b>	<b>1,487.8</b>

**CASH FLOW (MYR m)**

Pretax profit	65.7	52.2	70.5	114.7	146.5
Depreciation & amortisation	28.6	33.5	43.9	48.8	53.1
Adj net interest (income)/exp	0.0	0.0	0.0	0.0	0.0
Change in working capital	(15.4)	(114.0)	(60.6)	(59.2)	(54.1)
Cash taxes paid	(29.7)	(2.1)	(5.1)	(8.0)	(10.3)
Other operating cash flow	(11.0)	(1.5)	(5.2)	(4.4)	(5.2)
Cash flow from operations	49.2	(19.9)	60.1	110.7	149.8
Capex	(59.2)	(102.6)	(90.0)	(90.0)	(90.0)
Free cash flow	(10.0)	(122.5)	(29.9)	20.7	59.8
Dividends paid	0.0	(19.9)	(16.4)	(26.7)	(34.1)
Equity raised / (purchased)	292.8	0.5	0.0	0.0	0.0
Change in Debt	88.9	47.4	100.0	50.0	0.0
Other invest/financing cash flow	(340.8)	91.1	(43.9)	(46.0)	(47.0)
Effect of exch rate changes	(0.2)	(1.8)	0.0	0.0	0.0
Net cash flow	30.7	(5.1)	9.8	(2.0)	(21.3)

FYE 31 Mar	FY22A	FY23A	FY24E	FY25E	FY26E
<b>Key Ratios</b>					
<b>Growth ratios (%)</b>					
Revenue growth	2.3	25.5	25.2	21.3	15.5
EBITDA growth	5.4	(6.7)	34.5	39.0	20.5
EBIT growth	(2.4)	(15.7)	36.3	53.2	24.7
Pretax growth	(2.8)	(20.6)	35.1	62.8	27.7
Reported net profit growth	120.5	(37.3)	30.8	63.2	27.6
Core net profit growth	2.2	(38.8)	30.8	63.2	27.6
<b>Profitability ratios (%)</b>					
EBITDA margin	20.7	15.4	16.6	19.0	19.8
EBIT margin	15.0	10.1	11.0	13.9	15.0
Pretax profit margin	13.1	8.3	8.9	12.0	13.3
Payout ratio	25.0	25.0	25.0	25.0	25.0
<b>DuPont analysis</b>					
Net profit margin (%)	15.9	8.0	8.3	11.2	12.4
Revenue/Assets (x)	0.5	0.6	0.6	0.7	0.7
Assets/Equity (x)	1.7	1.7	1.8	1.8	1.7
ROAE (%)	19.0	8.1	10.0	14.8	16.8
ROAA (%)	10.0	4.8	5.7	8.2	9.5
<b>Liquidity &amp; Efficiency</b>					
Cash conversion cycle	91.3	117.1	142.1	145.3	147.8
Days receivable outstanding	67.8	66.3	68.0	69.2	70.7
Days inventory outstanding	110.2	109.7	117.3	120.6	122.1
Days payables outstanding	86.7	58.9	43.2	44.4	45.0
Dividend cover (x)	4.0	4.0	4.0	4.0	4.0
Current ratio (x)	3.6	3.0	3.2	3.4	3.4
<b>Leverage &amp; Expense Analysis</b>					
Asset/Liability (x)	2.5	2.5	2.3	2.3	2.4
Net gearing (%) (incl perps)	42.0	49.3	58.9	59.6	55.0
Net gearing (%) (excl. perps)	42.0	49.3	58.9	59.6	55.0
Net interest cover (x)	7.7	5.6	5.3	7.3	8.6
Debt/EBITDA (x)	2.7	3.5	3.3	2.7	2.2
Capex/revenue (%)	11.8	16.3	11.4	9.4	8.2
Net debt/ (net cash)	256.5	313.3	403.5	455.5	476.9

Source: Company; Maybank IBG Research

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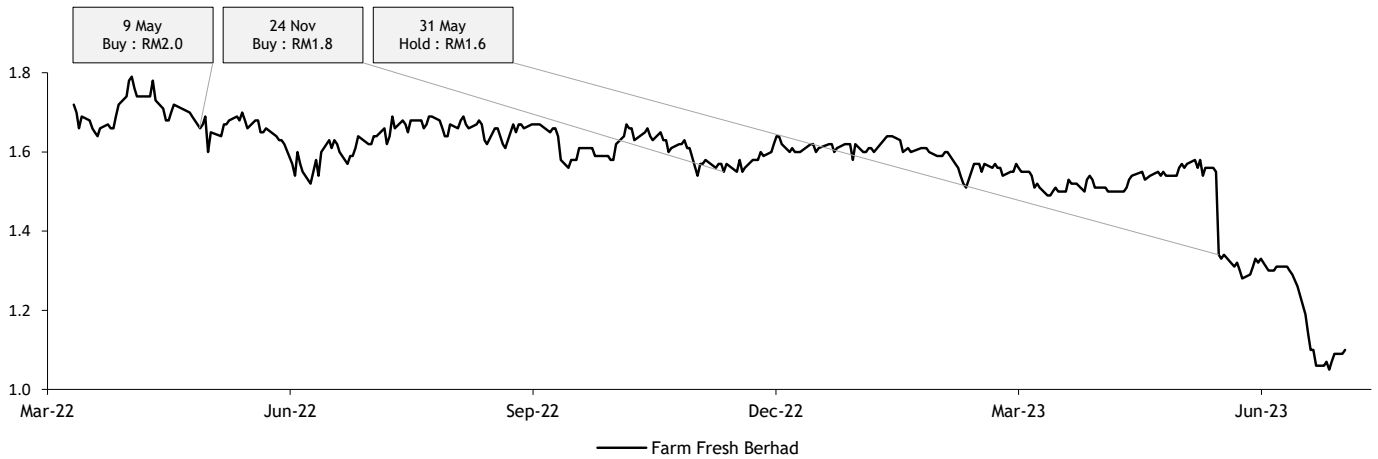
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