

Corporate Highlights

Briefing Note

C.I. Holdings

Sugar Bomb Dropped

28 January 2011

Share Price : RM3.51
Fair Value : RM3.88
Recom **Market Perform**
(Downgraded)

Table 1 : Investment Statistics (CIHLDG; Code: 2828)

Bloomberg: CIH MK

FYE	Turnover (RMm)	Net			PER (x)	C.EPS* (sen)	P/NTA (x)	Net				
		profit (RMm)	EPS (sen)	Growth (%)				Gearing (x)	P/CF (x)	ROE (%)	GDY (%)	
June												
2010a	516.4	38.1	26.8	65.7	14.0	-	4.7	0.34	13.9	25.7	3.5	
2011f	623.1	42.3	29.8	10.9	12.1	32.0	4.1	16.2	0.2	23.8	2.5	
2012f	734.8	42.5	29.9	0.6	12.0	36.0	4.0	9.0	net cash	20.5	2.5	
2013f	860.7	40.8	28.8	-3.9	12.5	41.0	3.9	6.7	net cash	17.3	2.4	

Main Market Listing / Non-Trustee Stock / Syariah-Approved Stock By The SC

* Consensus Based On IBES Estimates

◆ **Sugar bomb dropped.** During the analyst briefing yesterday, management highlighted that thirteen beverage manufacturers, including CI Holdings (CIH), were no longer allowed to purchase sugar at the subsidised price effective 1 Jan 2011. The other manufacturers include beverage makers such as F&N, Coca-Cola, Nestle and Dutch Lady. Currently, the subsidised price of sugar is RM2.10/kg, while the local non-subsidised price stands at RM2.62/kg which is 25% higher. Note that the current subsidised sugar price was increased last month from RM1.90/kg, which we believe was roughly the average sugar price recorded during CIH's 1HFY06/11, thus translating to a 37-39% price increase between the 1HFY11 and 2HFY11.

◆ **Impact to earnings.** We are imputing an increase in our sugar cost assumptions of 17.9% for FY11 and 28-38% for FY12-13. For FY12-13, we are assuming that 1HFY06/12 sugar prices will remain at current levels, while from 2H06/12 onwards we expect sugar prices to go higher once the Government's Long Term Contract (LTC) to buy raw sugar expires. We have assumed that the new LTC for local (non-subsidised) sugar would be increased by 10 sen to RM2.72/kg (from an average RM2.26/kg in FY11). Note that our price rise projections FY12-13 may be slightly optimistic given current price levels of >RM3/kg, but we believe that the Government's negotiated price would usually be at a slight discount given the large contract volume. (refer to Table 2 for sensitivity analysis).

◆ **Risks.** The risks include: 1) significant drop in demand; 2) significant increase in raw material prices such as crude oil and sugar; and 3) foreign exchange risk as CIH buys concentrate from PepsiCo in USD.

◆ **Forecasts.** After increasing our sugar cost assumptions, our FY11-13 earnings were revised downwards by 16-37%.

◆ **Downgrade to Market Perform.** After our earnings revision, our fair value is reduced to RM3.88 (from RM4.90 previously) based on unchanged 13x target CY11 PER. We believe that CIH will continue to be able to grow its topline, especially in the upcoming Chinese New Year festivities during the 3QFY06/11 which we are still expecting a strong surge in sales for its beverage division. Rerating catalysts would be: 1) a price increase across the board for CIH's beverage division of 3.5-5%; and 2) strong performance in the 3QFY06/11 results, which we believe indicates CIH's ability to ride the challenge of higher sugar prices. We downgrade our call on the stock to **Market Perform**.

Issued Capital (m shares)	142.0
Market Cap (RMm)	498.4
Daily Trading Vol (m shs)	0.1
52wk Price Range (RM)	1.7-4.0

Major Shareholders:	(%)
Datuk Johari Abdul Ghani	30.0
Continental Theme	10.4
PNB	8.2

FYE June	FY10	FY11	FY12
EPS chg (%)	(15.8)	(25.8)	(36.6)
Var to Cons (%)	(6.8)	(16.9)	(29.8)

PE Band Chart



Relative Performance To FBM KLCI



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Key takeaways from analysts briefing

- ◆ **Sugar bomb dropped.** During the analyst briefing yesterday, management highlighted that thirteen beverage manufacturers, including CI Holdings (CIH), were no longer allowed to purchase sugar at the subsidised price effective 1 Jan 2011. The other manufacturers include beverage makers such as F&N, Coca-Cola, Nestle and Dutch Lady. Currently, the subsidised price of sugar is RM2.10/kg, while the local non-subsidised price stands at RM2.62/kg which is 25% higher. Note that the current subsidised sugar price was increased last month from RM1.90/kg, which we believe was roughly the average sugar price recorded during CIH's 1HFY06/11, thus translating to a 37-39% price increase between 1HFY11 and 2HFY11. Sugar accounts for approximately 7.5% of total revenues for the beverage division (Permanis) in FY10 and we expect it to account for ~11% in FY11. We estimate that the increase in sugar price would cause CIH's FY06/11 EBIT and net margins to contract by 1.6%-pts and 1.2%-pts respectively.
- ◆ **Impact to earnings.** We are imputing an increase in our sugar cost assumptions of 17.9% for FY11 and 28-38% for FY12-13. For FY12-13, we are assuming that 1HFY06/12 sugar prices will remain at current levels, while from 2H06/12 onwards we expect sugar prices to go higher once the Government's Long Term Contract (LTC) to buy raw sugar expires. Note that the Government's Long Term Contract, which lasts for three years at a time is a contract that is negotiated with global sugar traders to acquire a percentage of the raw sugar required for domestic annual consumption at a fixed price (usually based on prevailing prices during the negotiation period). For example, the current local (non-subsidised) sugar price is at RM2.62/kg, which is based on the average price of the year of negotiation (2008), which covers 65-70% of the total domestic consumption volume. Thus, for the period of 2012-2014, the LTC would be based on global raw sugar prices at the time of negotiation. Current raw sugar is priced at more than RM3/kg. We have assumed the new LTC for local (non-subsidised) sugar would be increased by 10 sen from current price levels to RM2.72/kg for FY11-13 (vs. an average RM2.26/kg in FY11). Note that our price rise projections for FY12-13 may be slightly optimistic given current price levels of >RM3/kg, but we believe that the Government's negotiated price would usually be at a slight discount given the large contract volume (refer to Table 2 for sensitivity analysis).

Table 2. Sugar price impact on gross margin and EBIT

Chg in sugar price sen	FY12**				FY13**			
	Gross margin		EBIT		Gross margin		EBIT	
	%	RMm	% chg	%	RMm	% chg		
+ 0.00*	39.4	62.5	-	38.7	68.8	-		
+ 0.10	38.9	59.4	-5.0	38.3	65.1	-5.4		
+ 0.20	38.5	56.3	-9.9	37.9	61.5	-10.6		
+ 0.30	38.1	53.1	-15.0	37.4	57.8	-16.0		
+ 0.40	37.7	50.0	-20.0	37.0	54.2	-21.2		
+ 0.50	37.2	46.9	-25.0	36.6	50.6	-26.5		

Source: RHBRI estimates

*Based on current sugar price assumption of RM2.62/kg

**Assuming no rise in CIH's selling prices

- ◆ **CIH's strategy to protect margins.** We understand that CIH does not have any immediate plans to raise its selling prices to accommodate the rise in sugar prices. However, management indicated that they have various strategies planned to contain the effect of the higher prices on its margins, which include: 1) selectively increasing retail market prices of certain products where competitive dynamics allow; 2) control discounting and trade promotions to help improve GP margins; and 3) continue to shift its portfolio to more profitable segments or less sugar content products such as the non-carbonated segment. Currently, the non-carbonated segment comprises 40% of revenue and in general. We believe that these measures will, to a certain extent, protect CIH's margins, although we doubt that it will have a significant impact.
- ◆ **Price increase a possibility, but CIH not generally the price leader.** Given that the move by the Government would affect the whole beverage industry as a whole, we believe it won't be long before an industry-wide price increase would happen. We believe CIH is not generally the price leader when it comes to price increases but a price follower, which means that they would have to wait for other players to raise prices first before they can follow suit. Although we can't speak for the industry as a whole, based on our estimates, CIH's beverage division FY11 revenues would have to be increased by 3.5-5% for it to maintain the same level of

profitability, without any increase in volume. This means that CIH would have to increase the selling prices of almost all its products across the board by 3.5-5% to contain the higher sugar prices. We note that an increase in prices across the board is not likely as CIH normally increases the prices of certain product range and not all products at the same time. Nonetheless, for the time being, we are maintaining our original revenue assumptions as management does not have immediate plans to raise selling prices.

Forecasts

- ◆ **Forecasts.** After increasing our sugar cost assumptions, our FY11-13 earnings were revised downwards by 16-37%.

Risks

- ◆ **Risks to our view.** The risks include: 1) significant drop in demand; 2) significant increase in raw material prices like crude oil and sugar; and 3) foreign exchange risk as CIH buys concentrate from PepsiCo in USD.

Valuations and recommendations

- ◆ **Downgrade to Market Perform.** After our earnings revision, our fair value is reduced to RM3.88 (from RM4.90 previously) based on unchanged 13x target CY11 PER. We believe that CIH will continue to be able to grow its topline, especially in the upcoming Chinese New Year festivities during the 3QFY06/11 which we are still expecting a strong surge in sales for its beverage division. However, based on what we gathered from the recent "Sugar Industry" talk organised by RHBRI as part of our Food and Agriculture day, global sugar prices are expected to rise further due to supply demand dynamics, which we believe will continue to affect CIH's bottomline. Rerating catalysts would be: 1) a price increase across the board for CIH's beverage division of 3.5-5%; and 2) strong performance in the 3QFY06/11 results, which we believe indicates CIH's ability to ride the challenge of higher sugar prices. We downgrade our call on the stock to **Market Perform**.

Table 3. Earnings Forecasts

FYE Jun (RMm)	FY10a	FY11F	FY12F	FY13F
Turnover	516.4	623.1	734.8	860.7
Turnover growth (%)	42.3	20.7	17.9	17.1
Cost of Sales	(304.6)	(374.1)	(451.0)	(541.8)
Gross Profit	211.8	249.1	283.8	319.0
EBITDA	64.8	75.9	80.4	76.1
EBITDA margin (%)	12.6	12.2	10.9	8.8
Depr&Amor	13.6	18.8	23.3	21.6
Net Interest	(3.2)	(3.1)	(2.7)	(2.2)
Pretax Profit	48.0	54.1	54.4	52.2
Tax	(10.0)	(11.9)	(12.0)	(11.5)
Net Profit	38.1	42.3	42.5	40.8

Source: Company, RHBRI Estimates

Table 4. Forecast Assumptions

FYE Jun	FY11F	FY12F	FY13F
Carb-lines	4.00	4.00	4.00
Utilisation	75%	85%	97%
Non-carb lines	3	3	3
Utilisation	46%	57%	69%

Source: Company, RHBRI

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Stock Ratings

Outperform = The stock return is expected to exceed the FBM KLCI benchmark by greater than five percentage points over the next 6-12 months.

Trading Buy = Short-term positive development on the stock that could lead to a re-rating in the share price and translate into an absolute return of 15% or more over a period of three months, but fundamentals are not strong enough to warrant an Outperform call. It is generally for investors who are willing to take on higher risks.

Market Perform = The stock return is expected to be in line with the FBM KLCI benchmark (+/- five percentage points) over the next 6-12 months.

Underperform = The stock return is expected to underperform the FBM KLCI benchmark by more than five percentage points over the next 6-12 months.

Industry/Sector Ratings

Overweight = Industry expected to outperform the FBM KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

Neutral = Industry expected to perform in line with the FBM KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

Underweight = Industry expected to underperform the FBM KLCI benchmark, weighted by market capitalisation, over the next 6-12 months.

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