UPDATE REPORT

CIMB Research Report

19 March 2010

CI Holdings

New line adds fizz and pop

RECOM	Buy
PRICE	RM1.86
MKT CAPITALISATION	RM261.1m
BOARD	Main (Syariah stock)
SECTOR	Food & Beverage
INDEX COMPONENT	None

CIH MK / CIHB.KL

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Investment highlights

- **Maintain BUY.** We recently communicated with CIH's management on its capacity expansion. The Bangi facility was expected to hit maximum production in at least five years but Tropicana's wild success has shortened it to two years. To address the capacity constraint and allow for future growth, the company is now installing a RM45m new production line. The new line will have the capacity to manufacture about RM300m worth of products. We maintain our earnings forecasts and target price of RM2.63, pegged to an unchanged 20% discount to our 15x target market P/E given the stock's relatively low liquidity. CIH remains a BUY, with the potential re-rating catalysts being 1) additional production capacity, and 2) an increasingly marketable product line. We note that CIH may be an effective indirect exposure to PepsiCo given that PepsiCo brands make up 85% of CIH's product portfolio and 80% of the company's revenue.
- **Minute Maid is not a strong competitor.** Minute Maid, a fruit juice brand of PepsiCo's rival The Coca-Cola Company (TCCC), is available in Malaysia but is imported, leading to a pricing structure that is less competitive. Should TCCC decide to produce and bottle Minute Maid at its new RM1bn plant in Nilai, it may take some time for it to catch up with CIH which is already ahead of the game given its early-mover advantages.
- **Improved distribution.** CIH has been actively enhancing its distribution and now handles the bulk of the distribution itself. Its nationwide retail coverage is expected to grow from 35,000 outlets in 1H10 to 42,000 outlets by end-FY10, ranging from major accounts such as hypermarkets (Tesco, Carrefour, Giant), fast-food outlets (KFC and Pizza Hut), convenience stores (petrol stations and 7-Eleven) to supermarkets, sundry shops and school canteens. CIH services 70% of the fast-food market, which contributes around 7% to revenue. Profits are not exciting but the move is positive for branding.

Key stock statistics

FYE 30 Jun	2009	2010F
EPS (sen)	14.8	19.7
P/E (x)	13.0	9.7
Dividend/Share (sen)	7.0	10.0
NTA/Share (RM)	0.7	0.8
Book Value/Share (x)	0.7	0.8
Issued Capital (m shares)	129.6	142.0
52-weeks Share Price Range (RM)		RM0.86/RM1.92
Major Shareholders:		%
Datuk Johari Abdul Ghani		27.0
Continental Theme Sdn Bhd		11.1
ASB		7.0

Per share data

FYE 30 Jun	2007	2008	2009	2010F
Book Value (RM)	0.7	0.7	0.7	0.8
Cash Flow (sen)	16.1	22.0	27.8	31.0
Earnings (sen)	6.0	10.2	14.8	19.7
Dividend (sen)	0.0	4.0	7.0	10.0
Payout Ratio (%)	0.0	28.1	34.1	36.5
P/E (x)	31.9	18.7	13.0	9.7
P/Cash Flow (x)	12.0	8.7	6.9	6.2
P/Book Value (x)	2.9	2.7	2.6	2.4
Dividend Yield (%)	0.0	2.1	3.6	5.2
ROE (%)	9.0	15.9	21.8	24.6
Net Gearing (%)	83.4	83.2	83.0	73.6

Source: Company, CIMB estimates, Bloomberg

Recent developments

We recently communicated with the management, who shared with us its capacity expansion plan. The market's response to Tropicana fruit juices has surpassed management's expectations, forcing the company to expand its current facility way earlier than expected.

Earnings outlook

Tropicana and Lipton are market leaders. To recap, for the third straight quarter, CI Holdings (CIH) outdid expectations in 2QFY6/10, turning in a robust net profit of RM7.8m or 60% of our full-year forecast. 2Q net profit rose an impressive 95% yoy despite the absence of new products. Much of the earnings surge in 2Q came from the strong response to the Tropicana and Lipton Tea ranges. Tropicana, a PepsiCo brand, is leading the chilled ready-to-drink (RTD) juice segment with a market share of 32%, followed by Marigold Peel Fresh with 30% share and F&N's (FNH MK, Underperform) Sunkist which has a 13% slice of the market. Lipton Tea is also a leader in the RTD tea market with more than 30% market share, followed by F&N's Seasons with close to around 28% share and Yeo Hiap Seng's (YHS MK, Not Rated) Yeo's with around 25% of the market.

Beverages drive profits. In 1H10, the beverage business contributed 92% to group revenue and 93% to group profit while the remaining came from the sanitary and tapware business. In the beverage business, the revenue split between carbonated drinks and non-carbonated drinks is 60:40. Of the non-carbonated drinks' 40% contribution, 35% comes from Tropicana and Lipton, which are PepsiCo brands. Other PepsiCo brands that are in CIH's product portfolio are Mirinda, 7-Up, Gatorade, Mountain Dew, Sting and Everness. The beverage business is housed under wholly-owned unit Permanis.

Strong demand leads to capacity issues. The success of Tropicana has overshot management's expectations and put significant pressure on production lines. Tropicana Twister is often out of stock as the production lines cannot keep up with the unprecedented demand growth. The non-carbonated drinks are enjoying double-digit growth compared with single-digit growth for the carbonated drinks. Due to capacity issues, the company will not be launching new non-carbonated beverages in FY10. Furthermore, given the production constraint, Permanis has no choice but to move some of the Lipton production back to co-packers. Currently, the non-carbonated beverages are produced at a RM35m Bangi facility, which was commissioned in Mar 08. The facility also includes a PET line with the capability to produce juices, tea beverages and Asian drinks. It is running at full capacity (three shifts a day and seven days a week). Based on the initial plan, the Bangi facility was expected to hit maximum production in five years' time at the earliest but Tropicana's wild success has shortened it to two years.

New production line installed at Bangi plant. To address the capacity constraint and allow for future growth of Permanis's range of non-carbonated products, CIH is now installing a RM45m new production line for non-carbonated beverages at the Bangi facility. The new line will have the capacity to produce 600 bottles per minute, which is twice the speed of the existing PET line. At full capacity, the new line will have the ability to manufacture products worth RM300m. The new line will also allow contract-packed non-carbonated products to be brought back to in-house manufacture. The expected payback period is five years and the breakeven capacity utilisation is 20%. From the current 60:40, the revenue split between carbonated drinks and non-carbonated drinks is expected to hit 50:50 in two years' time given the additional capacity. Construction of the new production line has started and is expected to be completed by this Sep.

Minute Maid is not a strong competitor. As mentioned earlier, Tropicana's closest competitor is Marigold Peel Fresh. Minute Maid, a fruit juice brand of PepsiCo's rival The Coca-Cola Company (TCCC), is available in Malaysia but is imported, leading to a pricing structure that is less competitive. On 16 Mar, TCCC organised a groundbreaking ceremony for a RM1bn 12-hectare bottling plant in Nilai. TCCC's Malaysian unit, Coca-Cola Bottlers (M) Sdn Bhd, will be taking over the bottling and distribution operations once its existing franchise agreements with local partner F&N expire next Sep. The plant, which is expected to be operational by end-CY11, will support TCCC's core brands, namely Coca-Cola and Sprite. Should TCCC decide to produce Minute Maid at its new plant in Nilai, it may take some time for it to catch up with CIH which is already ahead of the game given its early-mover advantages.

Improved distribution. CIH has been actively enhancing its distribution and now handles the bulk of the distribution itself. Its nationwide retail coverage is expected to grow from 35,000 outlets in 1H10 to 42,000 outlets by end-FY10, ranging from major accounts such as hypermarkets (Tesco, Carrefour, Giant), fast-food outlets (KFC and Pizza Hut), convenience stores (petrol stations and 7-Eleven) to supermarkets, sundry shops and school canteens. CIH services 70% of the fast-food market, which contributes around 7% to revenue. Profits are not exciting but the move is positive for branding.

Figure 1: P&L analysis (RM m)

FYE 30 Jun	2007	2008	2009	2010F
Revenue	267.0	290.2	363.0	435.6
Operating Profit (EBIT)	38.1	52.3	67.2	74.3
Depreciation	(13.0)	(14.0)	(15.0)	(16.0)
Interest Expenses	(4.9)	(8.7)	(9.2)	(9.7)
Pretax Profit	7.3	15.6	28.0	32.6
Effective Tax Rate (%)	*(7.5)*	*7.1*	*25.2*	*14.0*
Net Profit	7.8	14.5	21.0	28.0
Operating Margin (%)	*14.3*	*18.0*	*18.5*	*17.0*
Pretax Margin (%)	*2.7*	*5.4*	*7.7*	*7.5*
Net Margin (%)	*2.9*	*5.0*	*5.8*	*6.4*

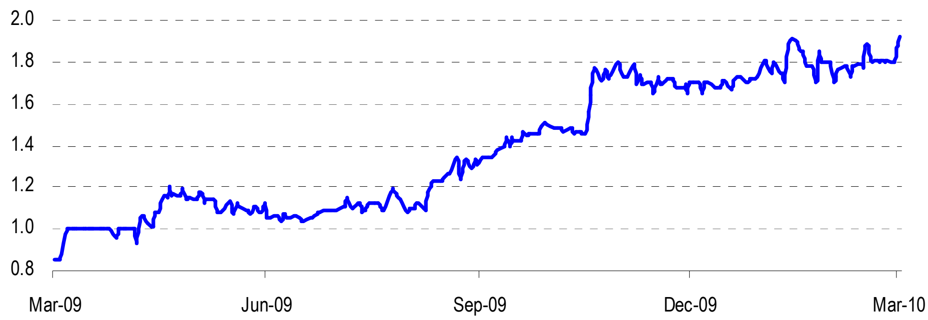
Source: Company, CIMB estimates

Recommendation

Undemanding valuations. From a loss-making entity to a turnaround story to a successfully executed turnaround story, CIH has posted 14 consecutive quarters of not just profits but continually improving results. The company's performance has exceeded our forecasts for three straight quarters. It also offers a breath of fresh air in a sector where interest is often capped by limited growth and pricey valuations. Despite the improvement in the share price (Figure 2), CIH's P/Es valuations remain undemanding at less than 10x against a 3-year EPS CAGR of 12%. We note that CIH may be an effective indirect exposure to PepsiCo (Figure 3) given that PepsiCo brands make up 85% of CIH's product portfolio and 80% of the company's revenue.

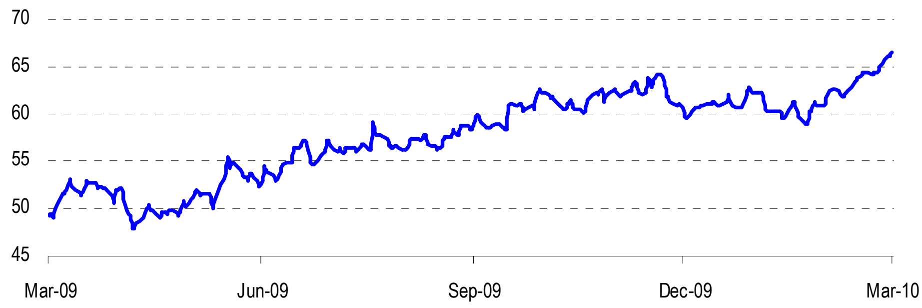
Maintain BUY. We maintain our forecasts and target price of RM2.63, pegged to an unchanged 20% discount to our 15x target market P/E to factor in the stock's relatively low liquidity. CIH remains firmly a BUY, with the potential re-rating catalysts being 1) an additional production capacity, and 2) an increasingly marketable product line.

Figure 2: CI Holdings' share price chart (RM)



Source: Bloomberg

Figure 3: PepsiCo's share price chart (US$)



Source: Bloomberg

Financial summary

FYE Jun	2008	2009	2010F	2011F	2012F
Revenue (RM m)	290.2	363.0	435.6	522.7	632.5
EBITDA (RM m)	38.3	52.2	58.3	61.0	51.3
EBITDA margins (%)	13.2	14.4	13.4	11.7	8.1
Pretax profit (RM m)	15.6	28.0	32.6	35.1	37.3
Net profit (RM m)	14.5	21.0	28.0	30.2	32.1
EPS (sen)	11.2	16.2	19.7	21.3	22.6
EPS growth (%)	+86%	+44%	+22%	+8%	+6%
P/E (x)	17.1	11.8	9.7	9.0	8.5
Core EPS (sen)	11.2	16.2	19.7	21.3	22.6
Core EPS growth (%)	+86%	+44%	+22%	+8%	+6%
Core P/E (x)	17.1	11.8	9.7	9.0	8.5
FD EPS (sen)	10.2	14.8	19.7	21.3	22.6
FD P/E (x)	18.7	13.0	9.7	9.0	8.5
Gross DPS (sen)	4.0	7.0	10.0	10.0	10.0
Dividend yield (%)	2.1	3.6	5.2	5.2	5.2
P/NTA (x)	2.7	2.6	2.4	2.3	2.2
ROE (%)	15.9	21.8	24.6	25.6	26.3
Net gearing (%)	83.2	83.0	73.6	71.7	69.8
P/CF (x)	8.7	6.9	6.2	5.8	5.7
EV/EBITDA (x)	6.6	4.9	4.4	4.2	4.9
% change in EPS estimates			-	-	-
CIMB/Consensus (x)			N/A	N/A	N/A

Source: Company, CIMB/CIMB-GK Research, Reuters Estimates

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