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CIMB

CIMB Research Report

UPDATE REPORT

30 March 2009

RECOM	Buy
PRICE	RM1.00
MKT CAPITALISATION	RM129.6m
BOARD	Main (Syariah stock)
SECTOR	Food & Beverage
INDEX COMPONENT	None

MALAYSIA

CI Holdings

Factory visit leaves us thirsty for more

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Investment highlights

- **PepsiCo-certified RM30m factory.** Recently, we took 25 fund managers and buy-side analysts on a tour of Permanis's PepsiCo-certified factory in Bangi. Permanis is 100%-owned by CI Holdings (CIH). The factory houses seven production lines for 1) carbonated soft drinks, 2) non-carbonated beverages, and 3) PET bottles.
- **No surprises but definitely an eye-opening visit.** There were no surprises from the visit. The management took the opportunity to throw light on its operations and showcase its products. For most of our group, it was their first contact with the management and their first time in an F&B factory.
- **Pepsi adds fizz to carbonated soft drinks sales.** Pepsi sales trail those of Coca-Cola's but the brand has its own following. In 2QFY6/09, Pepsi carbonated drinks contributed an estimated 70% to CIH's net profit. Indirectly referring to Coca-Cola's recent decision against renewing its agreements with F&N, Permanis stressed that its relationship with PepsiCo is solid. There is no divergence in interests since Permanis's and PepsiCo's products do not overlap.
- **Juicy Tropicana sales.** Launched in Mar 08, Tropicana orange and apple juices have enjoyed warm response from consumers and now contribute 10% to Permanis's sales, bumping Marigold Peel Fresh off the No. 1 spot in the fruit juice segment. Currently, Tropicana leads with a 26% market share, followed by Marigold with 21%.
- **31% FD EPS growth in FY6/09.** We forecast a fully diluted EPS growth of 31% in FY6/09, thanks to the first full-year contribution from Tropicana juices and an overall improvement in the sales of other products, i.e. Lipton, Sting, Gatorade, Chill and Bleu, as the company uses its new Bangi factory for products that were previously contract-packed.
- **Maintain BUY.** We maintain our forecasts and target price of RM1.64, pegged to an unchanged P/E of 15x, which is based on a 20% discount to the average valuation of bigger F&B producers. Dividend yield is attractive at 6.0%. We continue to rate CIH a BUY as the stock could be in for a re-rating given a stronger product line and a wider distribution network.

Key stock statistics

FYE 30 Jun	2008	2009F
EPS (sen)	7.8	10.2
P/E (x)	12.9	9.8
Dividend/Share (sen)	4.0	6.0
NTA/Share (RM)	0.7	0.7
Book Value/Share (x)	0.7	0.7
Issued Capital (m shares)	129.6	129.6
52-weeks Share Price Range (RM)		RM0.80/RM1.20
Major Shareholders:		%
Datuk Johari Abdul Ghani		26.2
ASB		18.5
Continental Theme Sdn Bhd		10.0

Per share data

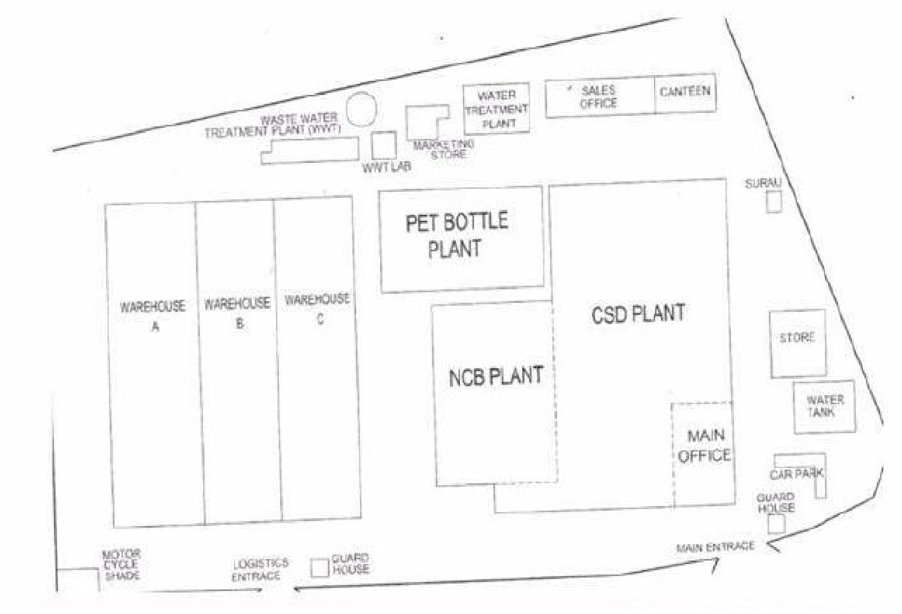
FYE 30 Jun	2006	2007	2008	2009F
Book Value (RM)	0.6	0.7	0.7	0.7
Cash Flow (sen)	5.8	16.1	22.0	26.2
Earnings (sen)	(2.9)	6.0	7.8	10.2
Dividend (sen)	0.0	0.0	4.0	6.0
Payout Ratio (%)	0.0	0.0	37.0	42.5
P/E (x)	nm	16.6	12.9	9.8
P/Cash Flow (x)	17.1	6.2	4.5	3.8
P/Book Value (x)	1.6	1.5	1.4	1.3
Dividend Yield (%)	0.0	0.0	4.0	6.0
ROE (%)	(4.6)	9.0	15.9	19.7
Net Gearing (%)	88.7	83.4	83.2	83.0

Source: Company, CIMB estimates, Bloomberg

Recent developments

PepsiCo-certified RM30m factory. On 19 Mar 09, we took 25 fund managers and buy-side analysts on a tour of the Permanis factory in Bangi. The RM30m factory started operations in Feb 08. Sprawled over a built-up area of five acres, the factory, which is certified by PepsiCo, houses seven production lines for 1) carbonated soft drinks, 2) non-carbonated beverages, and 3) PET bottles (Figure 1). Other facilities include warehouses and water treatment units. The plant employs 156 people. Permanis is 100%-owned by CI Holdings.

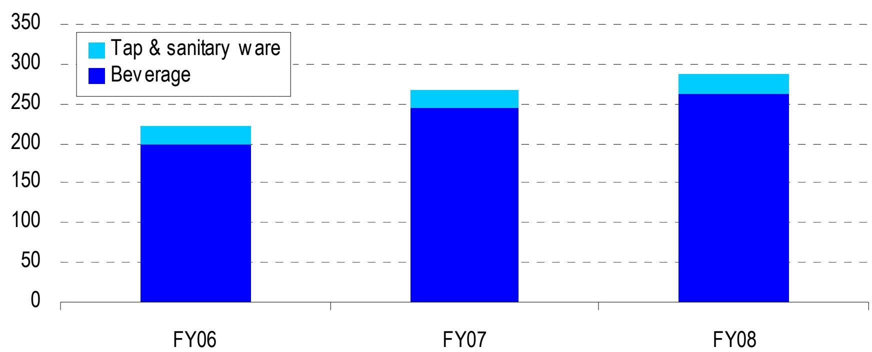
Figure 1: Production facility overview



CSD = Carbonated soft drinks
NCB = Non-carbonated beverages
Source: Company

90% revenue contribution. Established in 1973, Permanis is a leading manufacturer and distributor of beverages. Its portfolio includes PepsiCo brands (i.e. Pepsi, Mirinda, 7-Up, Tropicana and Gatorade) and in-house brands (i.e. Chill and Blue). The commissioning of the factory was a milestone for Permanis as it allows the company to expedite the launch of new products and manufacture products that were previously contract-packed. Apart from the factory in Bangi, Permanis also operates a factory in Meru which houses the production of mineral water. Its in-house brand is Bleu. It also produces TaHa mineral water for Lembaga Tabung Haji. In FY6/06-08, Permanis contributed around 90% to CIH's revenue (Figure 2). The remaining 10% is contributed by the tap and sanitary-ware business under the brands of Doe and Potex.

Figure 2: Revenue breakdown, FY6/06-08 (RM m)



Source: Company

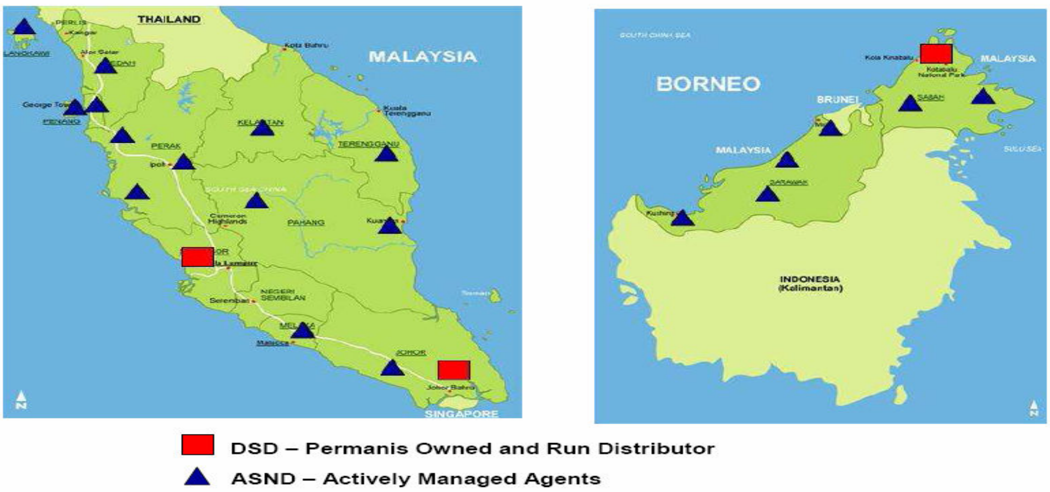
First time for most. There were no surprises from the visit. The management took the opportunity to throw light on its operations and showcase its products to us. For most of the group, the visit was their first contact with the management and their first time in an F&B factory. Our visit started with a corporate presentation by Mr. Syed Khalil Syed Ibrahim, CI Holdings' vice-president of corporate finance & planning, Mr. Erwin Selvarajah, Permanis's CEO and Mr. Reganathan Tewagudan, Permanis's supply chain VP. The presentation was followed by a lively Q&A session.

Wide distribution network. After the presentation, we adjourned to the warehouse to start the tour of the factory, which was bustling with activity. We saw crates of beverages that were packed and ready to be distributed (Figure 3). Permanis has a wide national distribution network that covers cities and major towns (Figure 4). To cut out middleman fees, the company handles the bulk of the distribution process itself (Figure 5). Its products ultimately reach 36,595 outlets nationwide (Figure 5), ranging from major accounts such as hypermarkets (i.e. Tesco, Carrefour and Giant), fast-food outlets (i.e. KFC and Pizza Hut) and convenience stores (i.e. petrol stations and 7-Eleven) to supermarkets, school canteens, mom-and-pop outlets and sports centres. In 2QFY6/08, Permanis secured exclusive distribution rights with Sports Planet, Malaysia's largest futsal operator with 13 outlets. In comparison, F&N (FNH MK, Underperform) distributes to more than 40,000 outlets.

Figure 3: Warehouse and logistics

Source: Company

Figure 4: Distribution footprint



Source: Company

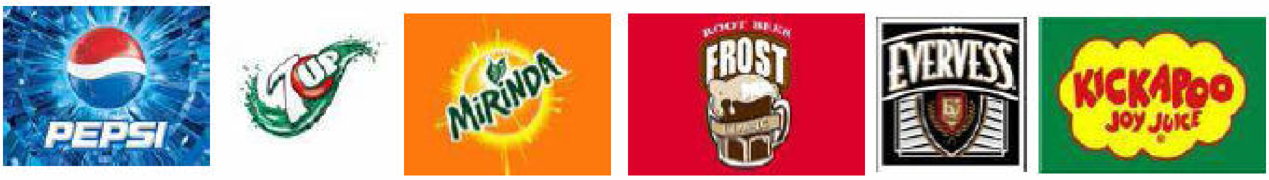
Figure 5: Distribution model

	Modern Trade (Hypers, Supers, C&G)	On Premise	Traditional Trade (Coffee, provision etc)		Wholesalers	
			KL/JB/KK	Other Regions		
% of Sales:	31%	7%	19%	23%	20%	= 100%
# Outlets	3,611	930	11,547	18,933	1,572	= 36,595
# Front line Selling Staff	78	15	67	98	11	= 269
Distribution Model	Direct by Permanis (DSD)	Direct by Permanis (DSD)	Direct by Permanis (DSD)	Via agents (ASND)	Large – Direct by Permanis Small - Via agents	
Partners	•Major national accounts •e.g. Carrefour, Giant, Jusco, •Makro, Tesco, 7-11, Gas	•Major national accounts •e.g. KFC, Pizza Hut	•3rd Party transporters	•~22 Strong multi-brand Agents	Large regional wholesalers	
	Direct Channels 57% of Volume, 44% of Outlets					
	Active Channels 80% of Volume, 96% of Outlets				Passive Channels 20% of Volume, 4% of Outlets	

Source: Company

Pepsi adds fizz to carbonated soft drinks sales. From the warehouse, we moved to the carbonated soft drinks production area where Pepsi, 7-Up, Mirinda, Frost Root Beer, Evervess and Kickapoo (Figure 6) beverages are produced. The Pepsi production was going on when we stopped at the production area (Figure 7). Pepsi's sales trail Coca-Cola's by 1:4 (Figure 8) but the brand has its own following. In 2QFY6/09, Pepsi carbonated drinks remained the backbone of CIH, with an estimated net profit contribution of 70%. Indirectly referring to Coca-Cola's recent decision against renewal of its agreements with F&N, Permanis stressed that its relationship with PepsiCo is solid and there is no divergence in interests since Permanis's and PepsiCo's products do not overlap.

Figure 6: Brands of carbonated soft drinks

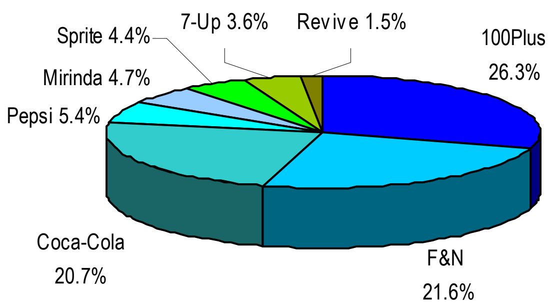


Source: Company

Figure 7: Pepsi production

Source: Company

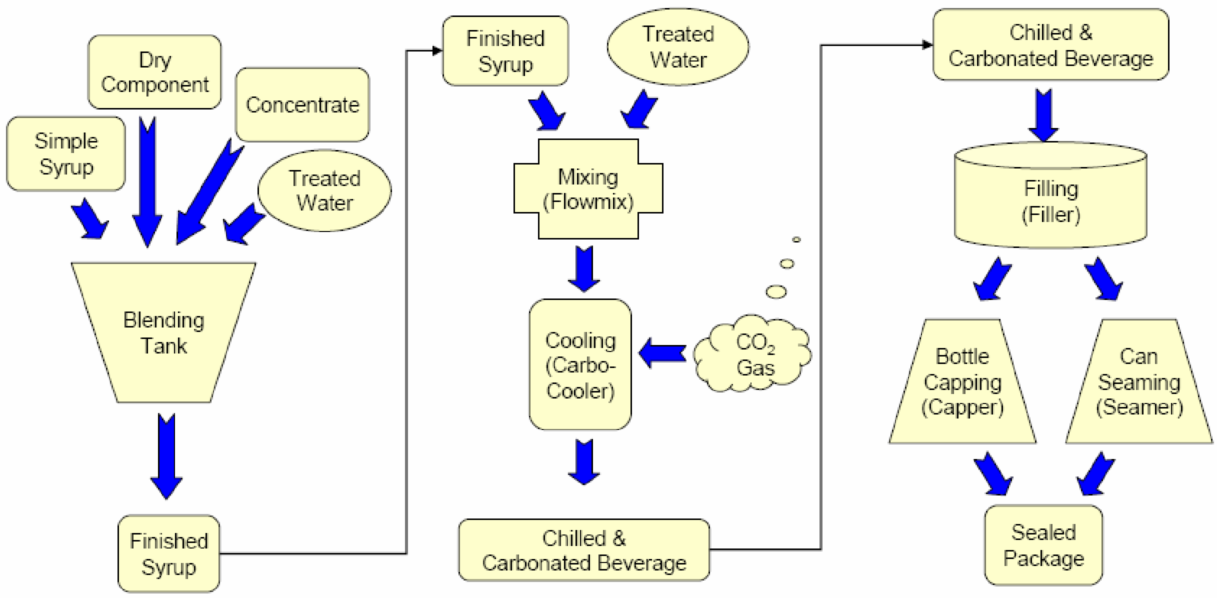
Figure 8: Market shares for carbonated soft drinks and isotonic drinks, Dec 08



Source: AC Nielsen

No raw material supply disruption. At the production area, the management also walked us through the elaborate process that is involved in the production of carbonated soft drinks (Figure 9). The concentrates are supplied by PepsiCo. The royalties that Permanis pays to PepsiCo are included in the concentrate charges. Sugar is sourced from long-time supplier Prai Sugar. So far there has been no supply disruption. The government controls the price of white sugar at around RM1.45-1.65/kg to protect household consumers. Commercial users such as Permanis pay higher prices which are not disclosed. Meanwhile, aluminium cans are sourced from Crown, which is appointed by PepsiCo. In comparison, F&N and Nestle (NESZ MK, Neutral) get their aluminium can supply from Kian Joo (KJC MK, Not Rated). On average, the price of a 325ml aluminium can is around 35 sen.

Figure 9: Production process for carbonated soft drinks



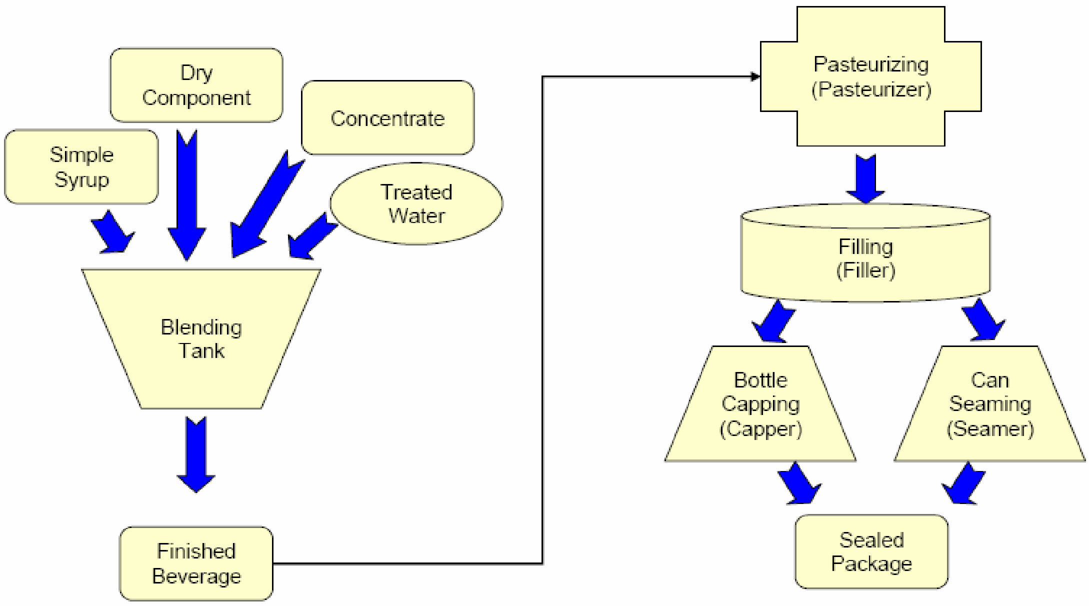
Source: Company

Juicy Tropicana sales. From the production area of carbonated soft drinks, we made our way to the production area of non-carbonated beverages, which include brands such as Lipton, Boss, Chill, Sting and Tropicana (Figure 10). Unlike the carbonated soft drinks, the production process for the non-carbonated beverages is less elaborate (Figure 11). The production of Tropicana orange juice was in full swing when we were at the production area. Launched in Mar 08, Tropicana orange and apple juices have enjoyed warm response from consumers and now contribute 10% of Permanis's sales. It has taken over the No. 1 spot in the fruit juice segment from Malaysia Milk Sdn Bhd's Marigold Peel Fresh. Currently, Tropicana has a 26% market share, followed by Marigold with 21%. Tropicana is the world's leader in the fruit juice segment. PepsiCo reportedly consumes 35% of the world's orange production.

Figure 10: Brands of non-carbonated beverages

Source: Company

Figure 11: Production process for non-carbonated beverages



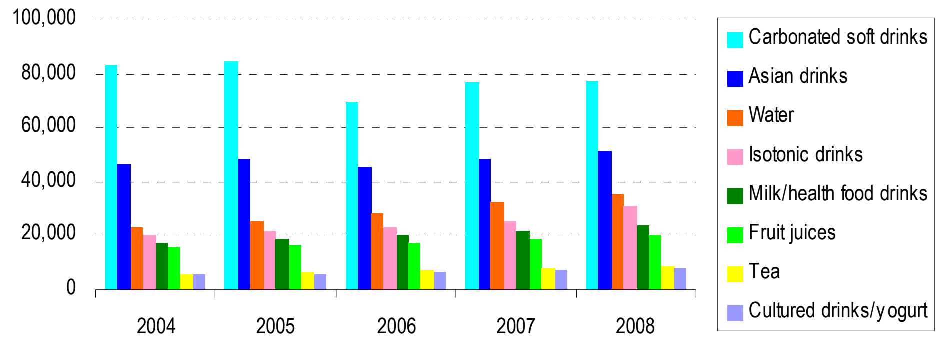
Source: Company

Chill is on hot expansion. Included in CIH's portfolio of non-carbonated beverages is the Asian drinks range, Chill (Figure 12). CIH began its involvement in the Asian drinks segment with soybean drink but add chrysanthemum tea and grass jelly drinks to the range after getting a positive response from consumers. In our sector note "Food & Beverages: The right ingredient for a safe portfolio" dated 3 Mar 09, we listed the Asian drink segment as one of the segments that should be in a better position to weather the economic slowdown. On the back of consumers' increasing health awareness, regional sales of Asian drinks have risen by 10% from 47m cases (1 case = 24 cans or bottles) in 2004 to 52m cases in 2008, making it one of the fast-growing segments in the F&B sector (Figure 13).

Figure 12: CI Holdings' Chill range

Source: Company

Figure 13: Regional industry volume for selected ready-to-drink beverages ('000 cases^)



^ 1 case = 24 cans or bottles

Source: Euromonitor, AC Nielsen, TNS Consumer Panel, Canadean, Margin Minder

Plastic wonder. Our last stop was the production area for PET bottles. A few years ago, both Permanis and F&N agreed to stop producing their carbonated soft drinks in glass bottles because the process of cleaning and recycling the bottles for future production was both costly and time-consuming. Currently, both companies' carbonated soft drinks are available in aluminium cans and PET bottles – both are not recycled for future production. At the production area, we saw plastic pieces the size of a thumb blown into plastic bottles. Like Permanis, F&N blows its own PET bottles too.

Earnings outlook

Ten consecutive quarters of profits. Once loss-making and debt-laden despite owning a strategic stake in KFC Holdings (KFC MK, Not Rated), CIH, under the management of CEO Datuk Johari Abdul Ghani, put its house in order in FY6/06. The effort has paid off. The company posted its 10^{th} straight quarter of profits in 2QFY6/09. Furthermore, in the same quarter, the company proposed an interim dividend of 2 sen/share – its first since the return to profitability.

31% FD EPS growth in FY6/09. We expect CIH's turnaround story to continue. We forecast a fully-diluted EPS growth of 31% in FY6/09, thanks to the first full-year contribution from Tropicana juices and an overall improvement in the sales of other products, i.e. Lipton, Sting, Gatorade, Chill and Bleu, as the company uses its new Bangi factory for products that were previously contract-packed.

More chillers nationwide. Brand visibility and product accessibility will be further improved. Currently, there are no less than 12,000 Pepsi and Tropicana chillers nationwide, up from around 10,000 in Oct 08. This improvement is commendable but there is definitely more room for growth given CIH's distribution network of 36,595 outlets.

Small treats. We project GDP growth to decelerate to 0.8% in 2009 before picking up to 3.0% in 2010. While it is true that consumers are likely to be more cautious with their spending this year, CIH may not be much affected as some 80% of its volume consists of products that retail at RM2 or less, ideal for cost-conscious consumers who want to indulge in small treats.

Figure 14: P&L analysis (RM m)

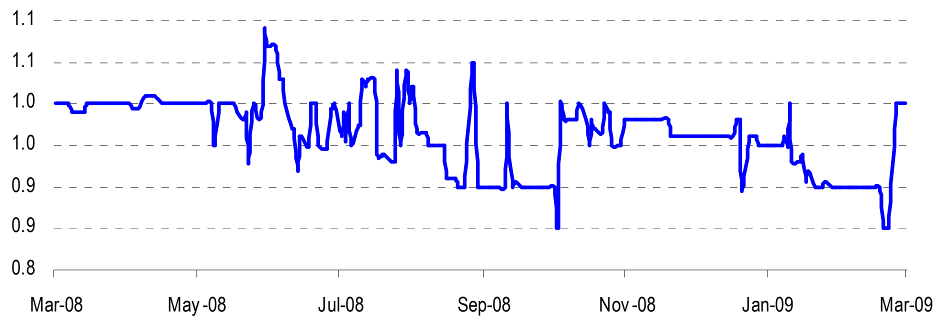
FYE 30 Jun	2006	2007	2008	2009F
Revenue	222.2	267.0	290.2	362.8
Operating Profit (EBIT)	24.8	38.1	52.3	61.3
Depreciation	(11.3)	(13.0)	(14.0)	(15.0)
Interest Expenses	(7.0)	(4.9)	(8.7)	(9.2)
Pretax Profit	(4.8)	7.3	15.6	22.1
Effective Tax Rate (%)	*na*	*(7.5)*	*7.1*	*14.0*
Net Profit	(3.8)	7.8	14.5	19.0
Operating Margin (%)	*11.2*	*14.3*	*18.0*	*16.9*
Pretax Margin (%)	*(2.2)*	*2.7*	*5.4*	*6.1*
Net Margin (%)	*(1.7)*	*2.9*	*5.0*	*5.2*

Source: Company, CIMB estimates

Recommendation

Reiterate BUY. We left the factory feeling positive. The visit was indeed an eye-opener. One of PepsiCo-certified factories is located in our backyard and it is run by a capable local team. We maintain our forecasts and target price of RM1.64, pegged to an unchanged P/E of 15x, which is based on a 20% discount to the average valuation of bigger F&B producers. Dividend yield is attractive at 6.0%. We acknowledge that the stock's lack of liquidity is a hindrance to active trading despite the strong fundamentals. However, we understand that the management is working to address the issue. We continue to rate CIH a BUY as the stock could be in for a re-rating given a stronger product line and a wider distribution network.

Figure 15: Share price chart (RM)



Source: Bloomberg

Financial summary

FYE Jun	2007	2008	2009F	2010F	2011F
Revenue (RM m)	267.0	290.2	362.8	435.3	522.4
EBITDA (RM m)	25.1	38.3	46.3	49.0	50.3
EBITDA margins (%)	9.4	13.2	12.8	11.2	9.6
Pretax profit (RM m)	7.3	15.6	22.1	23.3	24.4
Net profit (RM m)	7.8	14.5	19.0	20.0	21.0
EPS (sen)	6.0	11.2	14.7	15.4	16.2
EPS growth (%)	+308%	+86%	+31%	+5%	+5%
P/E (x)	16.6	8.9	6.8	6.5	6.2
FD EPS (sen)	6.0	7.8	10.2	10.7	11.2
FD P/E (x)	16.6	12.9	9.8	9.3	8.9
Gross DPS (sen)	-	4.0	6.0	6.0	6.0
Dividend yield (%)	-	4.0	6.0	6.0	6.0
P/NTA (x)	1.5	1.4	1.3	1.3	1.2
ROE (%)	9.0	15.9	19.7	19.7	19.9
Net gearing (%)	83.4	83.2	83.0	82.6	80.2
P/CF (x)	6.2	4.5	3.8	3.6	3.4
EV/EBITDA (x)	5.4	3.5	2.9	2.7	2.7
% change in EPS estimates			-	-	-
CIMB/Consensus (x)			1.26	1.23	-

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

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SELL: Expected negative total returns of 15% or more over the next 12 months.