RHB Research Institute Sdn Bhd
A member of the RHB Banking Group
Company No: 233327 -M

Corporate Highlights

New Coverage

18 November 2010

C.I. Holdings

Thirst Quenching Prospects

Share Price	:	RM3.66
Fair Value	:	RM4.90
Recom		**Outperform**
		(New Coverage)

Table 1 : Investment Statistics (CIHLDG; Code: 2828) — **Bloomberg: CIH MK**

FYE June	Turnover (RMm)	Net profit (RMm)	EPS (sen)	Growth (%)	PER (x)	C.EPS* (sen)	P/NTA (x)	Net Gearing (x)	P/CF (x)	ROE (%)	GDY (%)
2010a	516.4	38.1	26.8	65.7	13.7	-	4.7	13.9	0.3	25.7	3.5
2011f	623.1	49.5	34.8	29.8	10.5	31.0	4.1	13.2	0.2	27.5	2.8
2012f	734.8	57.3	40.4	15.9	9.1	36.0	4.0	6.6	net cash	26.4	3.3
2013f	860.7	64.4	45.3	12.3	8.1	37.0	3.9	4.3	net cash	24.8	3.7

Main Market Listing / Non-Trustee Stock / Syariah-Approved Stock By The SC — ** Consensus Based On IBES Estimates*

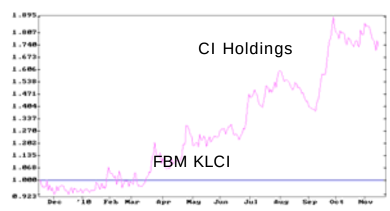
- **Background.** Currently, under its two subsidiaries namely Permanis and Doe Industries, C.I Holdings' principal activities are manufacturing and trading of beverages as well as tap ware and ceramic sanitary tap ware. Permanis has the exclusive right under a 5-year renewable EBA (Exclusive Bottling Agreement) with PepsiCo to manufacture, distribute and sell soft drinks under the Pepsi brand and other peripheral brands within Malaysia. Doe Industries is involved in manufacturing chrome-plated brass tap wares and sanitary fittings, while Potex (90% owned by Doe) is focused on manufacturing ceramic sanitary ware.
- **Historical 3-year earnings growth.** Since its turnaround to profitability in FY07, CIH's earnings have grown at an impressive CAGR of 52.6%, driven by growth in revenues and expanding margins due to economies of scale as a result of higher sales volume. During the same period, revenues grew by a CAGR of 24.7% while gross margins expanded throughout the three years from 36% in FY07 to 41% in FY10. Moving forward, we expect FY11-13 revenue and earnings to grow by a CAGR of 18.6% and 19% respectively, driven by strong growth in its non-carbonated beverages portfolio, especially its PepsiCo brands, Tropicana Twister and Lipton Tea.
- **Prospects.** 1) Stronger tie-up with PepsiCo; 2) weakening of competition; 3) Tropicana Twister to lead growth; 4) relative underpenetration of canned drinks; 5) extensive distribution channels; and 6) cross selling between tap and sanitary ware.
- **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**. For FY11-13, we are forecasting an earnings CAGR of 19% on the back of revenue CAGR of 18.6%, driven mainly by its non-carbonated drinks, specifically its Tropicana Twister products and new variants to the line. We expect earnings to grow slightly faster than revenue as we expect margins to remain stable, given that we believe its beverage division is already nearing critical mass.
- **Investment case.** We are valuing CIH at RM4.90 based on a target of 13x CY11 PER. The target PER is a discount of about 30% to the weighted average of its locally listed F&B peers such as F&N and Nestle of 17x FY11. The discount is due to CIH's smaller market capitalisation. We are optimistic on CIH's earnings outlook amid the recovering economy and consumer spending. A re-rating catalyst would be if CIH actually goes through with an M&A to purchase a snack manufacturer. We initiate coverage on CIH with an **Outperform** recommendation.

Issued Capital (m shares)	142.0
Market Cap(RMm)	521.1
Daily Trading Vol (m shs)	0.2
52wk Price Range (RM)	1.6-4.0
Major Shareholders:	**(%)**
Datuk Johari Abdul Ghani	30.0
Continental Theme	10.4
PNB	8.2

FYE June	FY10	FY11	FY12
EPS chg (%)	-	-	-
Var to Cons (%)	12.2	12.2	22.4

PE Band Chart

Relative Performance To FBM KLCI



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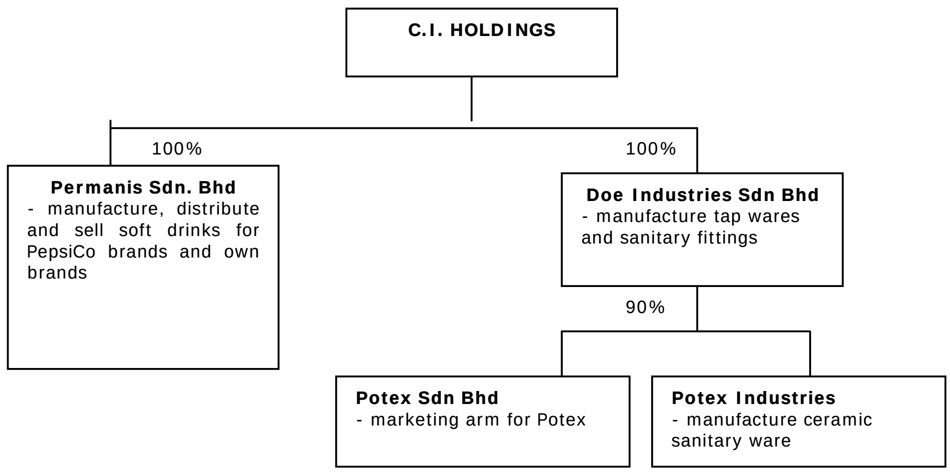
BACKGROUND

- **Principal activities.** C.I. Holdings was established in 1973 and was subsequently listed on the Main Market of Bursa Malaysia in 1983. Currently, under its two subsidiaries namely Permanis and Doe Industries, C.I Holdings principal activities are manufacturing and trading of beverages as well as tap ware and ceramic sanitary tap ware.

Figure 1. CI Holdings beverage portfolio



Source: Company

- **Beverage division.** This division under Permanis, has the exclusive rights under a 10-year renewable EBA (Exclusive Bottling Agreement) with PepsiCo to manufacture, distribute and sell soft drinks under the Pepsi brand and other peripheral brands within Malaysia. Approximately 80% of CIH's total beverage portfolio are PepsiCo brands with a wide span of beverage categories such as carbonated drinks, isotonic, juice, etc. The remaining 20% is contributed by its own brand drinks which are the beverage categories not served by PepsiCo (see Figure 2). In FY10, the beverage division contributed 93% and 87% towards revenues and EBIT respectively.

Figure 2. CI Holdings beverage portfolio

Source: Company

- **Tap ware and sanitary ware division.** Doe Industries is involved in manufacturing chrome-plated brass tap wares and sanitary fittings, while Potex is focused on manufacturing ceramic sanitary ware. Despite commanding higher prices, this division leverages on higher value proposition products with better quality, and is therefore well placed to compete against overseas competitors, especially from China, which compete by offering lower quality and lower-priced products. In FY10, the tap and sanitary ware division contributed 7% and 13% towards revenues and EBIT respectively.

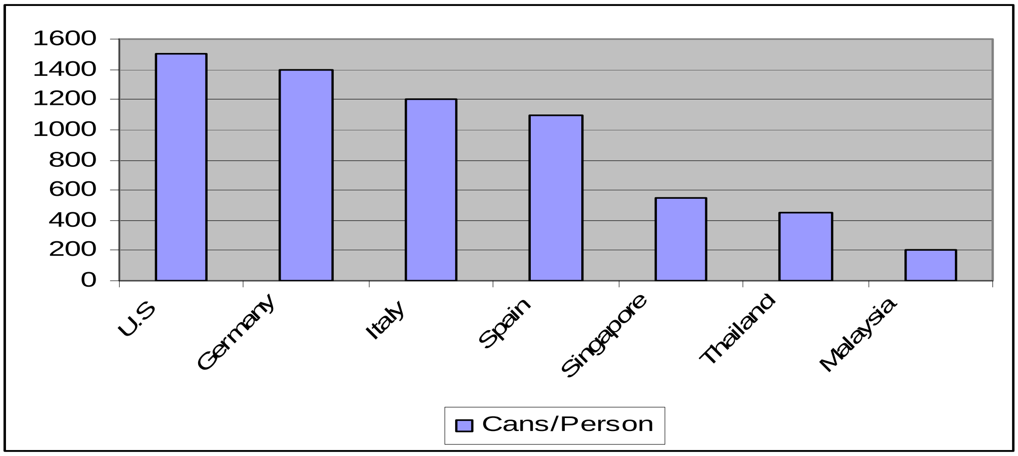
Figure 3. CI Holdings sanitary wear portfolio

Source: Company

INDUSTRY OUTLOOK

- **Relative under-penetration of canned beverages.** In terms of penetration of canned beverages, we understand that Malaysia is lagging behind not only developed countries, but regional countries such as Singapore and Thailand as well (Chart 4). We believe the lack of penetration is an opportunity for the CIH to grow with the overall canned beverages market as consumption increases. Furthermore, as the Government intends to focus more on increasing tourism traffic in Malaysia, we believe it will somewhat increase the per capita consumption of canned beverages. The closest example of this would be Singapore, whose yearly canned beverages consumption is 550 cans/person (Malaysia : 200 cans/person), which we believe is partially driven by its transient tourist traffic.

Chart 1. Penetration of canned beverages

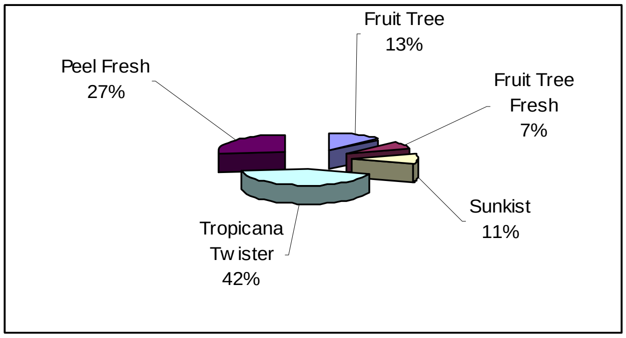


Source: Company

- **Boost from seasonal demand.** In Malaysia, the demand for beverages is positively influenced by major festive seasons such as Hari Raya Aidilfitri (HRA) and Chinese New Year (CNY), and we note that demand would normally pick up prior to the festive month. According to management, CNY normally brings in an average of ~10% higher revenue vs. Hari Raya Aidilfitri for beverages, given the more modern Chinese lifestyle which prefers RTD beverages for gatherings.

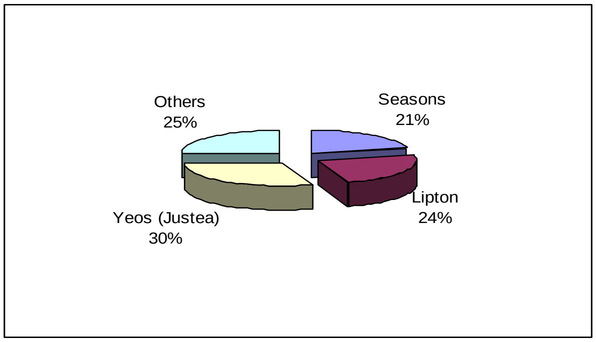
- **CIH and the non-carbonated beverage industry.** CIH is currently the leader in the chilled juice segment of the market through its Tropicana Twister juices, with an estimated ~42% (Chart 1) market share in FY10. Other brands inside the segment include Marigold's Peel Fresh (27%) and F&N's Fruit Tree (13%) market share. We believe that being the market leader, CIH will be able to easily pass on rising production costs to its consumers, assuming it needs to as Tropicana Twister is already a strong brand. For the RTD tea segment, CIH's Lipton Tea products ranks second behind Yeo's Justea (30%), with a 24% market share (Chart 2). Moving forward, we expect Lipton's market share to be maintained in the medium term given that Yeo's Justea has been in the market a lot longer.

Chart 2. Market share of chilled juice



Source: RHBRI's estimates

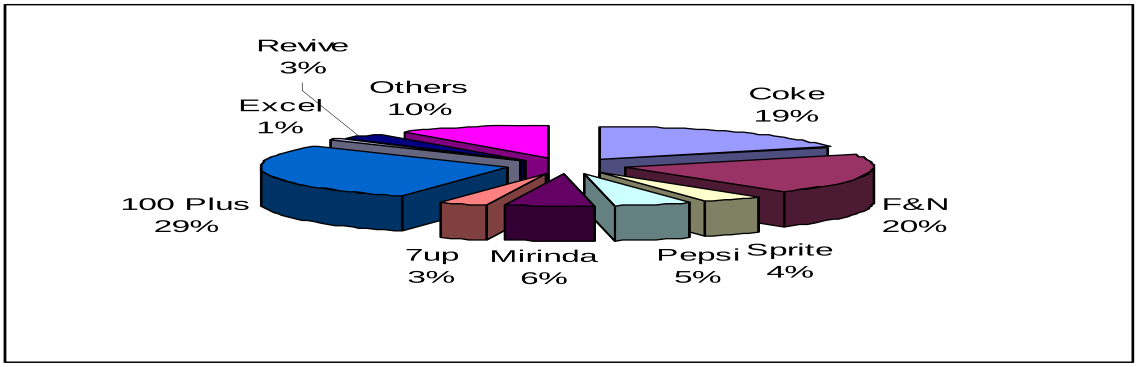
Chart 3. Market share of RTD tea



Source: RHBRI's estimates

- **Weaker F&N and Coca-Cola.** The carbonated segment, which includes carbonated isotonic drinks such as CIH's Revive and F&N's 100 Plus (29%), is where we believe, CIH has the potential to take away market share from its competitors (Chart 3). The carbonated segment is currently dominated by F&N, which has 100 Plus and other flavoured carbonated drinks, of which it has a combined total market share of ~49%. CIH currently has approximately 21% market share in the carbonated segment through a combination of isotonic (Excel and Revive), 7Up, Mirinda, and Pepsi. Coca-Cola currently controls 19% of the whole carbonated segment through its name-sake beverage. Moving forward, we expect CIH to be able to take on market share from both F&N and Coca-Cola, mainly through its Pepsi and Revive brand. F&N and Coca-Cola's partnership will effectively end starting from 1 Oct 2011. We believe this is a highly irregular occurrence which changes the dynamics of the soft drinks industry dramatically. Coca-Cola is intending to bottle and distribute its own products from 1 Oct 2011 onwards, while it is in the midst of constructing its bottling plant in Nilai, which is expected to be completed by Sept 2011. With this change, Coca-Cola will have to establish its own distribution infrastructure, logistics, transportation and warehousing, while trying to familiarise itself in a "new" market. Despite the fact that Coca-Cola will essentially be a "new" entrant in the market and provide more competition for existing soft drink players, we believe the transition time for Coca-Cola to re-establish its roots in the market would provide an opportunity for its competitors to steal market share. CIH for example, would be able to market itself as having a more "complete" portfolio of brands comprising cola, juice, tea, energy, isotonic drinks etc. than Coca-Cola or F&N, after the split. However, we believe that this window of opportunity may be a short-term one, given that both Coca-Cola and F&N will likely be aggressively introducing new brands and products into the market progressively in order to try to complete their brand portfolio. In the longer term, we believe competition will therefore intensify again to previous levels.

Chart 4. Market share of carbonated drinks



Source: Company

- **Potential snack business.** We understand that management is considering potential M&A's with local food manufacturing companies to increase its revenue base. However, we note that talks are still in preliminary stages. If a potential M&A were to happen, we believe that it gives CIH a significant boost as it can leverage on its relationship with PepsiCo to manufacture and distribute PepsiCo's snack products such as FritoLays, which are currently distributed in Malaysia through imports. We believe demand for the products is already in place currently driven by the urbanisation of consumers, despite its current high selling prices due to its import status. Thus, assuming CIH is able to manufacture the snacks at lower prices, we believe it would definitely be a strong revenue growth driver moving forward.

EARNINGS OUTLOOK

- **Historical 3-year earnings growth.** Since its turnaround to profitability in FY07, CIH's earnings have grown at an impressive CAGR of 52.6%, driven by growth in revenues and expanding margins due to economies of scale as a result of higher sales volume. During the same period, revenues grew by a CAGR of 24.7% while gross margins expanded throughout the three years from 36% in FY07 to 41% in FY10. Moving forward, we expect FY11-13 revenue and earnings to grow by a CAGR of 18.6% and 19% respectively, driven by strong growth in its non-carbonated beverages portfolio, especially its PepsiCo brands, Tropicana Twister and Lipton Tea.

- **Stronger tie-up with PepsiCo.** In June 30, PepsiCo renewed the exclusive bottling agreement (EBA) granted to CIH's Permanis, for a period of ten years to June 30, 2020. Previously, the EBA between both parties was renewed once every five years, thus the longer agreement period indicates PepsiCo's confidence in Permanis' ability to continue to grow its brands. We also believe that CIH's recent impressive turnaround story and subsequently continued revenue and profit growth had some part to play in the increased term of the agreement. Furthermore, we understand that although Permanis has its own brands, its core focus is to grow PepsiCo's brands more than its own, unlike another similar relationship i.e. F&N and Coca-Cola. An example of Permanis' commitment towards PepsiCo's brands is the Revive (PepsiCo) and Excel (Permanis) beverages, both in the carbonated isotonic beverages segment dominated by F&N's 100 Plus. When Revive was introduced, CIH aggressively marketed Revive, while its own brand, Excel took a backseat. Note that currently, Revive is ranked #2 while Excel is ranked #3 in the isotonic drinks sub-segment. In the same way, the introduction of Revive into the market was also an example of PepsiCo's support of CIH, as Revive was a brand created by PepsiCo for CIH to bring into the Malaysian market, given the need for CIH to compete with 100 Plus. Going forward, we expect more new products from PepsiCo which will cater towards local market tastes and demand, thus increasing CIH's competitiveness in the market.

- **Tropicana Juice to lead the growth.** The chilled juice market is currently dominated by CIH's Tropicana Twister with an estimated ~42% market share. Introduced in March 08, the product took the market by storm, where it immediately took market share away from the previous leaders Peel Fresh, while at the same time growing the whole segment. The value of the ready to drink (RTD) chilled juice segment is now estimated to be at RM400-500m (from RM200-250m in FY08). We estimate that revenues of Tropicana Twister grew by more than 50% in FY10. The success of Tropicana Twister has brought about new launches by other companies such as Coca-Cola's Minute Maid, among others. However, we believe given Tropicana's already established brand equity in the market and the distribution gap faced by Coca-Cola in Malaysia once the relationship with F&N ends in Sept 2011, it would take some time for Minute Maid to gear up and compete effectively in the market. As such, we expect moving forward, Tropicana Twister will grow by 25% p.a. for FY11-13, on the basis of: 1) increased chilled fruit juice consumption due to heightened health awareness amongst Malaysian consumers; and 2) its strong brand equity which is already cemented in consumers minds as evidenced by its strong growth since its launch. We expect the juice segment to contribute 35% to CIH's total revenue by FY12 (from 30% currently).

- **Capacity expansion.** The strong success of its Tropicana brand has prompted CIH to install a new RM45m non-carbonated beverage line which started production in Sept 2010. The new line will allow CIH to continue growing its non-carbonated beverage division, mainly its Tropicana Twister juices as we understand that the new line increases its non-carbonated production capacity by almost double and is capable of generating as much as ~RM300m in revenue p.a.. We also expect the new line to be able to address the seasonal capacity constraints thus allowing CIH to capitalise more on the seasonal jumps in demand, without having to outsource its excess production requirements, which will reduce margins. Previously, CIH's non-carbonated lines were running at full capacity during certain periods of the year such as the Hari Raya and Chinese New Year. CIH has also purchased a new warehouse located near its Bangi plant as its current warehouse is already full. The cost of the warehouse was RM30m. For its carbonated lines, we understand that management is looking to expand capacity by adding one new line to its existing four lines in FY12. We expect CIH to be able to ramp up capacity of its new line gradually over 2 years, to its optimal utilisation of 60-70% by FY13.

- **Extensive distribution channels.** It is estimated that the overall total distribution points in Malaysia is at around 90k, which consists of supermarkets, hypermarkets, among others. We understand that currently, CIH distributes its beverage products through 42k of these points (up from 40k a year ago). Its competitor F&N, distributes to approximately 45k points, while Coca-Cola is in the process of building up its distribution points, as it will no longer ride on F&N's distribution points come 1 Oct 2011. Moving forward, CIH aims to grow the number of its distribution points to 45k by the end of FY11. We believe this is achievable, given that CIH has strong brands such as Tropicana Twister which is the leading fruit juice in Malaysia to entice distributors to carry the whole range of its products.

- **New products.** In FY11 to-date, CIH has launched two new variants of its existing brands, i.e. Revive Lime Burst and Tropicana Blackcurrant. Its latest launch, the Tropicana Blackcurrant will be competing with Ribena's RTD Blackcurrant, which is estimated to be generating RM30-40m in revenues per year. Management hopes that Tropicana Blackcurrant will be able to take 30-40% of Ribena's market share within 12 months, which translates to incremental revenues of RM9-12m for CIH in FY11-12. Moving forward, we expect one more new launch from CIH by the end of FY11, as its strategy is to launch two to three products per year and focus on growing the products strongly as it has previously done.

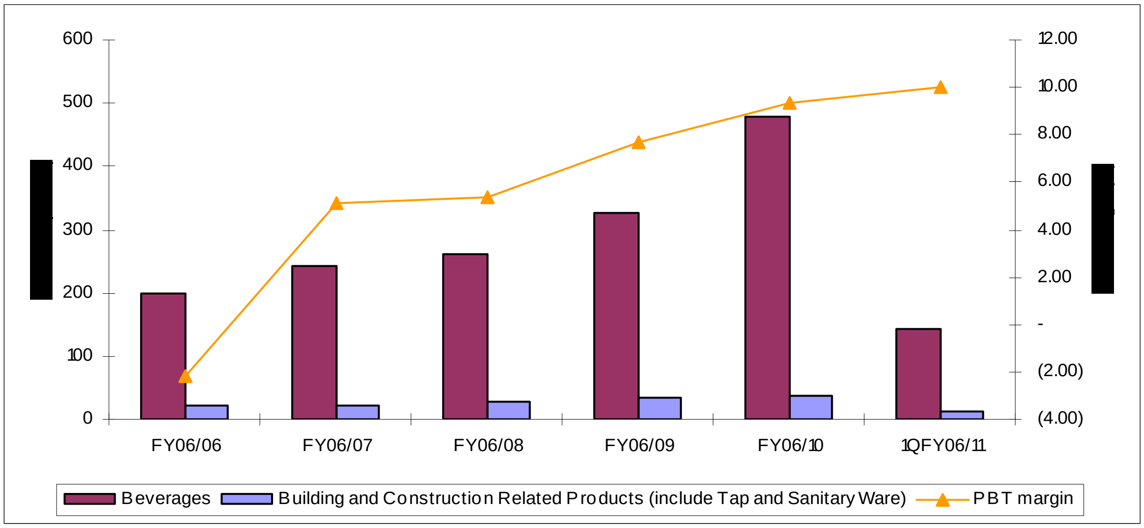
- **Maintaining margins.** CIH sources its beverage bases such as juice and concentrate from PepsiCo in USD, while its other significant costs such as packaging materials (i.e. cans and bottle resins) and sugar, are sourced from local suppliers. Due to its relationship with PepsiCo, CIH is able to leverage on the latter's global procurement scale and preferential rates with suppliers to obtain economical prices, thus enabling it to maintain a gross margin of 38-41% for its beverage division. CIH is however, exposed to USD fluctuations, which it counters by entering into forex hedges to counter forex risk. As for its other main raw materials like sugar and packaging materials (cans and bottle resins), which account for ~10% and ~32% of Permanis' cost of goods sold respectively, CIH counters any potential price fluctuations by entering into supply contracts to hedge its costs for six months at a time.

- **Cross selling of tap and sanitary ware.** Potex was acquired in February 2008, in order to complement CIH's existing Doe business of tap ware. Post-acquisition and a rationalisation exercise, management has (since late CY08) begun cross-selling activities for the products, with encouraging results. The success rate of its cross-selling activities have been about 30-60% so far. Currently, CIH's market share in tap ware is ~30% while the market share for sanitary ware is less than 5%, although we note that the sanitary ware industry is two times larger than the tap ware industry. Doe and Potex products are targeted to the middle and upper middle class segments, which we believe distinguishes itself and gives it a competitive edge against imported lower quality products especially from China which competes on lower prices. As we anticipate an increase in construction activities due to the improved economy, we believe CIH's advantage as the only locally manufactured "one-stop-shop" for tap and sanitary ware products would prove more fruitful in the future**.**

FORECASTS

- **Forecasts.** For FY11-13, we are forecasting an earnings CAGR of 19% on the back of revenue CAGR of 18.6%, driven mainly by its non-carbonated drinks, specifically its Tropicana Twister products and new variants to the line. We therefore expect its non-carbonated beverage division to contribute ~44% of the total beverage division revenues by end FY11 (1QFY11: 60:40). We expect earnings to grow slightly faster than revenue as we expect margins to remain stable, given that we believe its beverage division is already nearing critical mass. For its sanitary and tap ware division, we expect strong revenue CAGR of 22% for FY11-13, driven by the improving economy and more middle to high end property launches.

Chart 5. CIH Historical Performance



Source: Company

- **Balance sheet.** As at 1QFY11, CIH net gearing stood at 46%, up from FY10's 34% as it borrowed to expand its non-carbonated line and also for the purchase of a new warehouse. However, note that its net gearing has been trending down since its turnaround to profitability, from a high of 89% in FY06, to a low of 29% in FY09. We believe that moving forward, CIH will be able to pare down its borrowings and reduce its net gearing to ~20-30% levels, assuming a stable capex of RM10-12m for maintenance of its production lines. We understand that capex for FY11 will be approximately RM50m, which includes RM12m for its recurring maintenance capex, and RM37m for its warehouse and part of the new non-carbonated line installed in Sept 10.

- **Dividends.** Management does not have a dividend policy, although we understand that it targets to payout 30-35% of net earnings every year. However, assuming it does delve into an M&A with a food manufacturing company, we believe the dividend payout could be lower. Moving forward, based on a fixed payout policy of 30% of net earnings, we estimate that it would yield 3.4-4.4% p.a. for FY11-13.

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

- **Valuations.** We are valuing CIH at RM4.90 based on a target of 13x CY11 PER. The target PER is a discount to about 30% of the weighted average of its locally listed F&B peers such as F&N and Nestle of 17x FY11. The discount is due to CIH's smaller market capitalisation. We are optimistic on CIH's earnings outlook amid the recovering economy and consumer spending. A re-rating catalyst would be if CIH actually goes through with an M&A to purchase a snack manufacturer. We initiate coverage on CIH with an **Outperform** recommendation.

Table 2. Peer valuations

Company	Market cap (RMm)	FY11 PER (x)
Nestle	10177.3	23.5
F&N	5590.7	17.0
Mamee	520.6	10.8
Cocoaland	330.0	16.9
Average PER		17.1
Weighted average PER		**20.8**

Source: Bloomberg

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)	(364.8)	(432.0)	(511.6)
Gross Profit	211.8	258.3	302.8	349.2
EBITDA	**64.8**	**85.2**	**99.4**	**106.3**
EBITDA margin (%)	12.6	13.7	13.5	12.3
Depr&Amor	13.6	18.8	23.3	21.6
Net Interest	(3.2)	(3.1)	(2.7)	(2.2)
Pretax Profit	**48.0**	**63.3**	**73.4**	**82.4**
Tax	(10.0)	(13.9)	(16.2)	(18.1)
Net Profit	**38.1**	**49.5**	**57.3**	**64.4**

Source: Company, RHBRI Estimates

Table 4. Forecast Assumptions

FYE Jun	FY11F	FY12F	FY13F
Carb-lines total capacity (RMm value)	430	430	430
Utilisation	75%	85%	97%
Non-carb lines total capacity (RMm value)	550	550	550
Utilisation	46%	57%	69%

Source: Company, RHBRI

IMPORTANT DISCLOSURES

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The recommendation framework for stocks and sectors are as follows : -

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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