

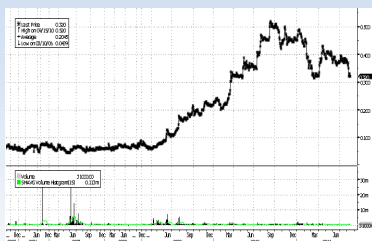
Overweight

Current Price S\$0.32
18 August 2011

Fair Value S\$0.41

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Historical Chart



Source : Bloomberg

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Stock Statistics

Market Cap	S\$171.1m
52-HI	S\$0.530
52-LOW	S\$0.285
Avg Vol	298,151
Shares Outstanding	534.6m
Free Float	168.2m

Key Indicators

ROE	35.7%
ROA	15.1%
P/BK*	1.9x
Gearing*	1.6x

*As at 30 Jun 2011

Major Shareholders

Tan Family	52.18%
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Improving trend in GPM

- **Results below expectation but turnaround in sight.** 3QFY11 PATMI of RM2.9m fell 84.2% YoY and 75.1% QoQ due to weaker than expected revenue growth from Dairies, higher than expected operating and finance costs and the inclusion of one-off fees associated with a RM368m syndicated loan facility. 9MFY11 PATMI of RM18.3m (excluding one-off item of RM14.5m) amounted to about 51% of our FY11 forecast of RM35.8m. Although we are expecting stronger 4QFY11 earnings, we have lowered our FY11 earnings to RM29.7m to account for the one-off loan fees and a rising interest rate environment.
- **Improving trend in GPM with easing raw material prices.** A slowdown in economic growth is expected to lead to lower demand for commodities and temporary relief in commodity prices. In particular, milk powder, a key raw material has fallen about 32% from its peak prices in March as high prices have spurred farmers in the US and New Zealand to boost production. Over the past three quarters, Etika has raised the selling prices in both local and export markets at Dairies to keep up with rising raw material costs. Falling trend of raw material costs will lift GPM and enhance the bottomline directly.
- **Other divisions. Packaging** will continue to ride on growth in the Dairies. The strong Ringgit vs US dollar will mitigate the impact of higher costs of tin plates. Competition remains keen in **Frozen Food** but promising growth in higher-margin Butchery and Bakery business and the strong Ringgit will mitigate margin pressure. Faced with greater competition with the entry of US competitors into Australia and New Zealand (ANZ) and rising raw material costs, **Nutrition** will continue to face margin pressure.
- **Valuation and Recommendation.** Etika is expected to benefit from increasing global consumption of liquid-dairy products, particularly with the expansion of middle income class in Asia. GPM is also expected to improve in 4QFY11 and FY12 with easing raw material costs. As the Group consolidates its existing and newly acquired businesses, cost control initiatives will further enhance the bottomline. We are expecting core earnings decline of -55.1% (FY11F) (previously -45.9%) but raise our core earnings growth prospects for FY12 to +49.9% (previously +38.8%), followed by +34.3% (FY13F) (previously +34.8%). We maintain our valuation on Dairies at PER of 21x (FY12), Frozen Food :PER of 10x (FY12), Packaging :PER of 7x (FY12), Nutrition :PER of 16x (FY12) and Beverage : PER of 11x (FY12). We lowered the discount to valuation from 30% to 20% to account for the improving trend of GPM and maintained our target price of 41.0Scts, which implies a PER of 19.2x (FY11), 12.8x (FY12) and 9.6x (FY13) on the core business. We upgrade to **overweight** in light of improving GPM trend.

Key Financial Data

RMm					
YE 30 Sep	FY09	FY10	FY11F	FY12F	FY13F
Sales	600.3	677.7	864.7	952.6	1,013.4
Gross Profit	152.9	174.2	189.8	213.9	225.3
Net Profit	61.7	66.2	40.3	44.5	59.8
EPS (RM cents)	11.7	12.2	7.1	7.9	10.6
EPS growth (%)	54.3	4.8	-41.8	10.5	34.3
PER (x)	6.6	6.4	11.1	10.0	7.5
DPS (RM cents)	3.4	2.6	1.8	1.9	3.6
Div Yield (%)	4.3	3.3	2.3	2.4	4.6

Result Review

3QFY11 PATMI of RM2.9m fell 84.2% YoY and 75.1% QoQ due to weaker than expected revenue growth from Dairies, higher than expected operating and finance costs as well as the inclusion of a one-off fee associated with a RM368m syndicated loan facility used to fund business expansion and acquisitions.

Group revenue improved 21.4% YoY to RM215.3m largely due to better sales performance in Dairies and Frozen Foods and contributions from newly acquired ready-to-drink and fresh bakery operations in Malaysia as well as instant noodle business in Indonesia. In particular, Dairies benefitted from rising volume and selling prices on both local and export markets. However, revenue dipped 2.7% QoQ and we believe this was largely due to the impact of weakening USD versus Ringgit which affected US-denominated exports at Dairies as exports accounted for about 46% of Dairies revenue.

Despite strong revenue growth, gross profit rose a mere 2% YoY to RM48.9m due to a 28.7% increase in costs of goods to RM166.3m as a result of higher costs of key raw materials, namely milk powder and palm oil as well as the withdrawal of sugar subsidy by the Malaysian government. As a result, gross profit margin (GPM) fell 4.4% points YoY to 22.7% in 3QFY11. On QoQ basis, gross profit dipped a marginal 0.6% and GPM improved 0.5% points to 22.7% as Dairies started to benefit from easing raw material costs in 3QFY11. In particular, whole milk powder prices have fallen about 32% from peak prices in March 2011.

Despite stabilising GPM, operating profits was dragged lower by 58.7% YoY and 45.5% QoQ to RM10.4m due to rising overall operating expenses which rose 46.5% YoY and 23.5% QoQ to RM43.0m. This was due to higher administrative expenses incurred by the newly acquired businesses. PBT fell even steeper by 83.9% YoY and 76.3% QoQ as financing costs surged 132% due to rising costs of borrowing and the inclusion of a one-off fee associated with a syndicated loan facility.

Rising gearing with expansion. As at 30 June 2011, gearing rose to 1.6x from 1.3x as at 31 Mar 2011 due to higher utilisation of trade facilities which grew in tandem with growing sales of the core businesses, as well as financing facilities utilised for acquiring new businesses in Malaysia and Indonesia.

3QFY2011 Results						
Profit & Loss (RMm)						
Year end: 30 Sep	3QFY11	3QFY10	YoY % Change	3QFY11	2QFY11	QoQ % Change
Revenue	215.2	177.2	21.4%	215.2	221.2	-2.7%
Cost of Sales	(166.3)	(129.3)	28.7%	(166.3)	(172.0)	-3.3%
Gross Profit	48.9	48.0	2.0%	48.9	49.2	-0.6%
Operating income	4.5	6.6	-31.7%	4.5	4.7	-4.1%
Negative goodwill	-	-	nm	-	-	nm
Operating Expenses	(43.0)	(29.4)	46.5%	(43.0)	(34.8)	23.5%
Administrative expenses	(17.3)	(11.8)	46.1%	(17.3)	(9.2)	88.7%
Selling & Marketing expenses	(10.8)	(6.2)	73.4%	(10.8)	(11.7)	-7.7%
Warehouse and distribution expenses	(9.9)	(7.4)	33.7%	(9.9)	(8.1)	22.1%
Research & development expenses	(0.5)	(0.3)	53.3%	(0.5)	(0.4)	13.5%
Other operating expenses	(4.6)	(3.6)	27.4%	(4.6)	(5.5)	-16.2%
Impairment of goodwill	-	(3.6)	nm	-	-	nm
Operating Profit	10.4	25.2	-58.7%	10.4	19.1	-45.5%
Finance Costs	(6.8)	(2.9)	132.0%	(6.8)	(4.0)	69.5%
Pre-tax Profit	3.6	22.3	-83.9%	3.6	15.1	-76.3%
Income tax	(0.8)	(4.3)	-80.8%	(0.8)	(3.1)	-73.3%
Minority interest	0.1	0.1	6.9%	0.1	(0.5)	nm
Net Profit	2.9	18.1	-84.2%	2.9	11.5	-75.1%
EPS - fully diluted (RMcts)	0.50	6.78	-92.6%	0.50	4.59	-89.1%

Profit & Loss					
YE 30 September (RMm)					
	2009A	2010A	2011F	2012F	2013F
Revenue	600.6	677.7	864.7	952.6	1,013.4
Cost of Sales	(447.8)	(503.5)	(674.9)	(738.6)	(788.2)
Gross Profit	152.9	174.2	189.8	213.9	225.3
Operating Income	6.8	9.5	17.1	25.7	28.2
Negative goodwill	-	-	14.5	-	-
Administrative expenses	(30.2)	(32.2)	(51.8)	(54.2)	(53.1)
Selling & Marketing exp.	(24.7)	(27.6)	(39.2)	(43.2)	(46.0)
Warehouse & distribution exp	(22.0)	(23.9)	(33.0)	(34.5)	(36.0)
Research & Development exp	(1.0)	(1.0)	(1.6)	(1.8)	(1.9)
Other operating expenses	(2.9)	(11.1)	(19.5)	(19.3)	(18.5)
Operating Profit	78.8	87.8	76.3	86.5	98.1
Net interest	(7.4)	(8.2)	(20.0)	(22.5)	(21.3)
Exceptional Items	-	-	-	-	-
Profits from Associated Co.	-	-	-	-	-
Pre-tax Profit	71.5	79.6	56.2	64.0	76.8
Income tax	(9.8)	(13.7)	(15.1)	(16.0)	(13.1)
Minority Interests	(0.0)	0.2	(0.9)	(3.5)	(4.0)
Net Profit	61.7	66.2	40.3	44.5	59.8

Balance Sheet					
YE 30 September (RMm)					
	2009A	2010A	2011F	2012F	2013F
Cash & Fixed Deposit	28.5	30.2	17.3	19.7	26.3
Trade Receivables	105.9	134.3	170.6	185.3	199.9
Inventory	67.4	102.9	138.7	147.7	161.9
Other current assets	1.6	0.8	0.8	0.8	0.8
Current Assets	203.5	268.3	327.4	353.5	389.0
Property, Plant and Equipment	148.5	190.4	291.9	306.0	319.2
Others	27.8	39.4	134.3	134.3	134.3
Non-current Assets	176.3	229.8	426.2	440.3	453.5
Bank Borrowings	62.9	109.1	122.1	109.9	98.9
Bank OD	4.1	3.9	38.3	38.3	38.3
Trade Payable	67.0	68.1	114.6	123.4	136.0
Others	5.7	6.4	12.1	12.4	12.7
Current Liabilities	139.7	187.5	287.2	284.1	286.0
Bank Borrowings	58.6	83.8	207.6	211.8	213.9
Others	14.0	13.8	15.9	15.9	15.9
Non-current Liabilities	72.6	97.5	223.5	227.6	229.7
Shareholder's Equity	167.5	213.0	242.9	282.0	326.8

Cash Flow					
YE 30 September (RMm)					
	2009A	2010A	2011F	2012F	2013F
Cash flow from Operating activities					
Pre-tax profits	71.5	79.6	56.2	64.0	76.8
Adjustments	21.4	24.7	21.1	38.5	36.9
Operating cash flow before working capital	92.9	104.3	77.4	102.5	113.7
Changes in working capital	24.0	(72.9)	(23.4)	(13.0)	(14.3)
Tax paid & others	(8.6)	(12.1)	(14.0)	(14.9)	(11.9)
Net cash generated from operations	108.3	19.3	40.1	74.6	87.4
Cash flow from investing activities					
Acquisition of subsi., net of cash	(1.3)	(27.5)	(116.5)	(5.8)	(0.3)
Property, plant & equipment	(36.0)	(22.6)	(24.6)	(24.3)	(24.3)
Others	0.5	0.2	0.6	0.9	1.5
Net cash from investing activities	(36.8)	(49.9)	(135.7)	(29.2)	(23.0)
Cash flow from financing activities					
Loans	(31.4)	63.1	84.4	(8.8)	(9.2)
Others	(24.8)	(26.5)	(35.0)	(35.3)	(44.9)
Net cash from financing activities	(56.3)	36.7	49.4	(44.1)	(54.1)
Net change in cash	15.2	6.1	(46.2)	1.3	10.3
Cash balance at beginning of year	7.8	23.4	25.3	(21.0)	(18.7)
Other adjustments	0.4	(4.2)	(0.2)	1.1	(3.6)
Cash balance at end of year (net of OD & adjms)	23.4	25.3	(21.0)	(18.7)	(12.0)

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