Etika International Holdings Ltd

Results Update

Maintain BUY

Current Price **S$0.455**
23 November 2010

Fair Value S$0.50

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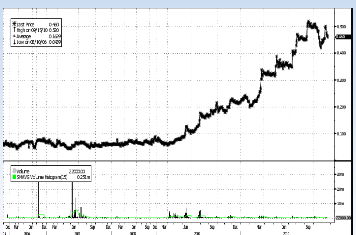
Historical Chart



Source : Bloomberg

Stock Statistics

Market Cap	S$243.2m
52-HI	S$0.53
52-LOW	S$0.20
Avg Vol	307,231
Shares Outstanding	534.6m
Free Float	168.1m

Key Indicators

ROE	35.7%
ROA	15.1%
P/BK	2.7x
Gearing	0.8x

Major Shareholders

Tan Family	52.14%

Recent acquisitions will propel Etika to the next level of growth

- ***Results marginally below expectations.*** Etika reported FY9/10 PATMI growth of 7.2% to RM66.2m on the back of a 12.8% growth in revenue to RM677.7m. Although overall gross profit margin (GPM) improved 0.3% points to 25.7% in FY9/10 largely due to lower costs of key raw materials, PATMI growth was only 7.2% due to a 285% increase in other operating expenses. This arose from higher foreign exchange losses in respect of receivables from export sales in FY9/10 as a result of the weakening US dollar against the Ringgit. All the divisions recorded higher revenue with the exception of the Packaging division. Dairies division remained the key contributor, contributing about 70.5% and 73.9% to Group revenue and EBIT respectively. The results were marginally below our expectations as a result of lower-than-expected GPM and higher- than-expected other operating expenses.

- ***Currency strength will cushion against margin pressure arising from higher raw material costs.*** Forward growth will be underpinned by ***Dairies*** division on the back of strong brand equity and pricing policy in Malaysia and ASEAN markets. Rising raw material costs are expected to exert some pressure on GPM but the impact is likely to be mitigated by the strength of the Ringgit versus US dollar. ***Packaging*** will continue to see steady growth in demand for tin cans, riding on growth in the Dairies division but competition to third-party customers will remain keen. The new mechanism for iron ore pricing has put upward pressure on tinplate pricing, however the strong Ringgit vs US dollar will mitigate the impact of higher raw material costs. ***Frozen Food*** will continue to face price-cutting in the FMCG business 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 the Australia and New Zealand (ANZ) markets and rising raw material costs, ***Nutrition*** will also come under margin pressure. However, new product innovation, coupled with price increases, will cushion against margin compression as well as help to retain and grow its leading position in ANZ.

- ***Risks.*** Further weaknesses in US dollar will continue to pose a negative impact on US dollar-priced export sales to the Africa market for the Dairies division.

- ***Integrating new and existing operations for further growth.*** Etika recently acquired a profitable fresh bakery operation in Malaysia and an instant noodle manufacturing and distribution operation in Indonesia and is close to completing the acquisition of a ready-to-drink operation in Malaysia. These businesses are expected to impact Group bottomline in FY9/11 and management will now focus on integrating these new acquisitions into existing businesses to propel the Group to the next level of growth.

- ***Valuation and Recommendations.*** In view of GPM pressure arising from inflation of raw material prices, we have lowered our earnings estimates to 19.0% (FY9/11F) (previously +22.4%) and 7.3% (FY9/12) (previously +22.1%). We have raised the valuation of all the various divisions, except for Nutrition, in view of higher peer valuations. For the Dairies, we apply PER of 17x (FY9/11) (previously PER 16x (FY9/11), Frozen Food : PER of 10x (FY9/11) (previously PER 7x (FY9/11), Packaging : PER of 7x (FY9/11) (previously PER 5x (FY9/11), Nutrition : PER of 13x (FY9/11) (unchanged) and Beverage : PER of 8x (FY9/11) (previously PER 12x (FY9/11). We maintain our valuation of S$0.905 and target price of S$0.50, implying a relatively undemanding PER of 8.3x (FY9/11) and 7.7x (FY9/12). **Maintain BUY.**

Key Financial Data					
RMm					
YE 30 Sep	**FY08**	**FY09**	**FY10**	**FY11F**	**FY12F**
Sales	592.3	600.3	677.7	848.0	935.2
Gross Profit	129.8	152.9	174.2	218.7	234.5
Net Profit	40.3	61.7	66.2	78.7	84.5
EPS (RM cents)	7.6	11.7	12.2	14.6	15.6
EPS growth (%)	240.6	54.3	4.8	19.0	7.3
PER (x)	14.0	9.4	8.9	7.5	7.0
DPS (RM cents)	1.9	3.4	2.6	2.9	3.3
Div Yield (%)	1.7	3.1	2.4	2.7	3.0

Valuations

Notwithstanding the strength of the Ringgit, we expect further downward pressure on GPM in light of rising raw material costs. Accordingly, we lower our earnings growth estimates to 19.0% (FY9/11F) (previously +22.4%) and 7.3% (FY9/12) (previously +22.1%)

We continue to value each of the five business divisions independently. We raise the valuation of all the divisions, with the exception of Nutrition, in view of higher peer valuations. For the Dairies division, we apply PER of 17x (FY9/11) (previously PER 16x (FY9/11), Frozen Food division : PER of 10x (FY9/11) (previously PER 7x (FY9/11), Packaging division : PER of 7x (FY9/11) (previously PER 5x (FY9/11), Nutrition division : PER of 13x (FY9/11) (unchanged) and Beverage division : PER of 8x (FY9/11) (previously PER 12x (FY9/11). We arrive and maintain our valuation of S$0.905.

Notwithstanding the recent bonus issue, share illiquidity still prevails as Etika shares remain tightly held by major shareholders. We maintain our discount of 45% to valuation and target price of S$0.50, implying a relatively undemanding PER of 8.3x (FY9/11) and 7.7x (FY9/12).

Results Review

Etika reported FY9/10 PATMI growth of 7.2% to RM66.2m on the back of a 12.8% growth in revenue to RM677.7m. Overall GPM improved 0.3% points to 25.7% in FY9/10 largely due to lower costs of key raw materials such as tinplates and skim milk powder from Packaging and Dairies respectively. However, PATMI grew by only 7.2% largely due to a 285% increase in other operating expenses. This arose largely from higher foreign exchange losses in respect of receivables from export sales in FY9/10 as a result of the weakening US dollar against the Ringgit.

All the divisions recorded higher revenue with the exception of the Packaging division. ***Dairies*** division remained the key contributor, contributing about 70.5% and 73.9% to Group revenue and EBIT respectively and registering revenue and EBIT growth and 16% YoY and 5.1% YoY respectively. Sales growth was largely from the Malaysia and ASEAN markets, predominantly from the Philippines and Vietnam, which partially offset sales decline in the Africa market. Specifically, sales volume improved in both the domestic and export markets by 15% YoY and 21.1% YoY respectively and the domestic market also benefitted from a 1.1% increase in average selling prices per carton. However, there was a fall of 1.3% in the average selling prices per carton in the export markets, but the decline was offset by lower manufacturing costs arising from lower costs of major raw materials (tin cans and skim milk powder) and economics of scale, resulting in an improvement in GPM for Dairies. Notwithstanding that, EBIT margin declined 1.41% points to 13.62% (FY9/10) from 15.03% (FY9/09) due to higher foreign exchange losses in respect of receivables from US dollar-priced export sales to the Africa market in FY9/10 as a result of the weakening US dollar versus the Ringgit.

Frozen Food division grew 14% in revenue to RM135m due to growth in trading (+15.5%), FMCG (+5.3%) as well as butchery and bakery (+20.3%) sub-divisions. The improvement arose from higher sales arising from new outlets opening in the restaurant chain and hotel customers while the bakery sub-division saw higher demand from OEM customers. Higher contributions from the higher-margin butchery and bakery sub-divisions as well as the strengthening Ringgit against the US dollar softened the impact of rising costs of raw materials, lifting EBIT margins by 2.67% points to 7.91% in FY9/10.

The ***Packaging*** division, which predominantly supports Dairies, saw a decline in revenue by 65.2% YoY to RM5.7m due to keen competition of non-related party sales to aerosol manufacturers. Easing tinplate prices since 4QFY9/10 as well as the strength of the Ringgit vs US dollar helped to improve GPM by 0.7% points YoY to 13.9% in FY9/10 and lifted EBIT growth of 39.1% to RM10.0m. Inter-segment sales improved 8.3% YoY due to higher sales volume in the Dairies division.

Other divisions grew 10% YoY to RM58.9m arising largely from strong performance of the Nutrition division which contributed 93.3% and 86.8% to revenue and after-tax profit of Other divisions.

In view of business expansion and higher working capital commitments, operating cash flow was lower in FY9/10 and net gearing increased to 0.80x as at 30 Sep 2010 from 0.60x as at 30 Sep 2009.

As a result of the strong profitability, Group NAV per share improved to 79.9 RMcts as at 30 Sep 2010 from 69.2 RMcts as at 31 March 2010 and 66.1RMcts as at 30 Sep 2009.

Also, management declared a final dividend of 1.25 Scts in FY9/10 (FY9/09: 2.0Scts). In addition to an interim dividend of 1.0 Scts (FY9/09: 0.8 Scts), the Group declared a total dividend of 2.25 Scts in FY9/10.

FY9/2010 Results

Profit & Loss (RMm) **Year end: 30 Sep**	**FY9/10**	**FY9/09**	**YoY % Change**
Revenue	677.7	600.6	12.8%
Cost of Sales	(503.5)	(447.8)	12.5%
Gross Profit	174.2	152.9	13.9%
Operating income	9.5	6.8	39.9%
Operating Expenses	(95.8)	(80.8)	18.7%
Administrative expenses	(32.2)	(30.2)	6.7%
Selling & Marketing expenses	(27.6)	(24.7)	11.7%
Warehouse and distribution expenses	(23.9)	(22.0)	8.8%
Research & development expenses	(1.0)	(1.0)	1.2%
Other operating expenses	(11.1)	(2.9)	285.3%
Impairment of goodwill	-	-	nm
Operating Profit	87.8	78.8	11.4%
Finance Costs	(8.2)	(7.4)	10.8%
Pre-tax Profit	79.6	71.5	11.3%
Income tax	(13.7)	(9.8)	39.6%
Minority interest	0.2	(0.0)	-8166.7%
Net Profit	66.2	61.7	7.2%
EPS - fully diluted (RMcts)	24.49	23.36	4.8%

Profit & Loss YE 30 September (RMm)	2008A	2009A	2010A	2011F	2012F
Revenue	592.4	600.6	677.7	848.0	935.2
Cost of Sales	(462.6)	(447.8)	(503.5)	(629.3)	(700.7)
Gross Profit	129.8	152.9	174.2	218.7	234.5
Operating Income	2.9	6.8	9.5	10.5	11.5
Administrative expenses	(34.2)	(30.2)	(32.2)	(39.5)	(40.1)
Selling & Marketing expenses*	(38.3)	(24.7)	(27.6)	(34.5)	(38.1)
Warehouse & distribution expenses	-	(22.0)	(23.9)	(29.9)	(32.3)
Research & Development expenses	-	(1.0)	(1.0)	(1.3)	(1.4)
Other operating expenses	(6.3)	(2.9)	(11.1)	(12.5)	(12.4)
Accreditation of negative goodwill	-	-	-	-	-
Operating Profit	53.8	78.8	87.8	111.4	121.7
Net interest	(9.4)	(7.4)	(8.2)	(15.7)	(15.9)
Exceptional Items	-	-	-	-	-
Profits from Associated Co.	-	-	-	-	-
Pre-tax Profit	44.4	71.5	79.6	95.7	105.8
Income tax	(3.8)	(9.8)	(13.7)	(16.3)	(18.0)
Minority Interests	(0.3)	(0.0)	0.2	(0.7)	(3.4)
Net Profit	40.3	61.7	66.2	78.7	84.5

* FY08 Selling & Marketing expenses include Warehouse & distribution and R&D expenses

Balance Sheet YE 30 September (RMm)	2008A	2009A	2010A	2011F	2012F
Cash & Fixed Deposit	15.6	28.5	30.2	43.0	78.9
Trade Receivables	112.3	105.9	134.3	151.0	171.7
Inventory	81.3	67.4	102.9	112.1	128.6
Other current assets	-	1.6	0.8	0.8	0.8
Current Assets	209.2	203.5	268.3	306.9	380.0
Property, Plant and Equipment	110.6	148.5	190.4	198.7	211.0
Others	27.6	27.8	39.4	153.9	156.2
Non-current Assets	138.3	176.3	229.8	352.6	367.2
Bank Borrowings	98.8	62.9	109.1	98.2	88.3
Bank OD	6.8	4.1	3.9	3.9	3.9
Trade Payable	60.3	67.0	68.1	86.2	96.0
Others	4.4	5.7	6.4	6.7	7.0
Current Liabilities	170.4	139.7	187.5	194.9	195.2
Bank Borrowings	53.4	58.6	83.8	174.1	191.5
Others	10.3	14.0	13.8	13.8	13.8
Non-current Liabilities	63.6	72.6	97.5	187.9	205.3
Shareholder's Equity	113.5	167.5	213.0	276.8	346.8

Cash Flow YE 30 September (RMm)	2008A	2009A	2010A	2011F	2012F
Cash flow from Operating activities					
Pre-tax profits	44.4	71.5	79.6	95.7	105.8
Adjustments	24.6	21.4	24.7	31.0	31.3
Operating cash flow before working capital	69.0	92.9	104.3	126.7	137.1
Changes in working capital	(48.9)	24.0	(72.9)	(5.8)	(25.4)
Tax paid & others	(4.7)	(8.6)	(12.1)	(15.2)	(16.9)
Net cash generated from operations	15.3	108.3	19.3	105.7	94.9
Cash flow from investing activities					
Acquisition of subsi., net of cash	-	(1.3)	(27.5)	(114.9)	(5.7)
Property, plant & equipment	(19.6)	(36.0)	(22.6)	(19.6)	(24.3)
Others	1.1	0.5	0.2	0.6	0.9
Net cash from investing activities	(18.5)	(36.8)	(49.9)	(134.0)	(29.1)
Cash flow from financing activities					
Loans	21.7	(31.4)	63.1	77.3	6.7
Others	(19.3)	(24.8)	(26.5)	(35.1)	(37.6)
Net cash from financing activities	2.4	(56.3)	36.7	42.2	(30.9)
Net change in cash	(0.8)	15.2	6.1	14.0	34.8
Cash balance at beginning of year	6.6	7.8	23.4	25.3	39.2
Other adjustments	3.0	0.4	(4.2)	(0.2)	1.1
Cash balance at end of year (net of OD & adjms)	**7.8**	**23.4**	**25.3**	**39.2**	**75.1**

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