

Farm Fresh Bhd

Success Story of "Grass to Glass"

TP: RM1.75 (+29.6%)

Main Market Listing

Buy (ESG: ★★★)

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We initiate coverage on Farm Fresh Bhd (FF) with a Buy recommendation and TP of RM1.75 based on 28x CY23 earnings. We like FF for i) being the Malaysian leading integrated dairy group, ii) having recognised brand built on distinct fresh milk proposition, and iii) operating extensive multi-channel network for optimal market penetration. We are also positive on FF's plan to expand capacity across its value chain alongside goal of penetrating into new regional markets i.e., Indonesia and Philippines.

Background

FF is an integrated dairy group, which is engaged in farming, manufacturing and distribution of dairy products and plant-based products.

IPO Statistic

The IPO entails public issue of 223.0mn new shares, representing 12.0% of the group's enlarged share capital and an offer for sales of up to 520.2mn shares, representing 28.0% of the group's enlarged share capital. Meanwhile, there is an over-allotment option of up to 44.6mn shares, representing 2.4% of the group's enlarged share capital. At an issue price of RM1.35/share, the IPO implies a market capitalisation of RM2.5bn.

New Share Issuance and Offer for Sale:

- 37.2mn shares for application by the Malaysian public;
- 18.6mn shares for application by eligible persons;
- 455.2mn shares allocation to selected investors;
- 232.2mn shares allocation to identified Bumiputera investors approved by MITI.

Investment Merits

1. Leading Integrated Dairy Group;
2. Recognised Brand Built on Fresh Milk Proposition; and
3. Extensive Multi-Channel Distribution Network.

Earnings Forecast

We estimate the group to record earnings growth of 9.7/18.6/20.6% YoY to RM84.7/100.5/121.2mn for FY22/23/24 (3-year CAGR of 16.2%). We initiate coverage on FF with a Buy recommendation and target price of RM1.75/share based on 28x CY23 earnings.

FYE Mar (RM mn)	2020	2021	2022E	2023F	2024F
Revenue	303.1	490.5	548.8	633.1	710.5
EBITDA	56.6	98.8	118.9	145.3	174.3
Adj. EBIT	42.6	82.2	88.8	117.1	142.8
PBT	36.2	67.6	83.9	109.5	135.6
Net profit	35.2	36.2	90.3	100.5	121.2
Core net profit	29.4	77.2	84.7	100.5	121.2
Core EPS (sen)	1.6	4.2	4.6	5.4	6.5
Core PER (x)	85.5	32.5	29.6	25.0	20.7
DPS (sen)	0.0	0.0	1.1	1.4	1.6
Div. yield (%)	0.0	0.0	0.8	1.0	1.2

Share Information

Listing	Main Market
Enlarged Share Capital (mn)	1858.0
Market Cap @ RM1.35 (RM mn)	2508.2
Issue price (RM)	1.35
Oversubscription rate	N/A
Estimated free float (%)	40.0-42.4%
Tentative listing date	22-Mar-22

Tentative Listing Dates

Event	Tentative Date
Opening of the IPO	28-Feb-22
Closing of the IPO	8-Mar-22
Ballotting of Applications	11-Mar-22
Allotment of Shares	18-Mar-22
Listing	22-Mar-22

Ratio & Analysis

NTA per share (post IPO) (RM)	0.3
Price to NTA (x)	4.5
Proforma Gearing (x)	0.49

Utilisation of Proceeds	RM(mn)	%
Capex		
-Malaysian Expansion	140.0	46.5
-Australian Production Facility	60.0	19.9
-Regional Expansion	40.0	13.3
Working capital	40.8	13.6
Estimated listing expenses	20.2	6.7
TOTAL	301.0	100.0

Business Overview

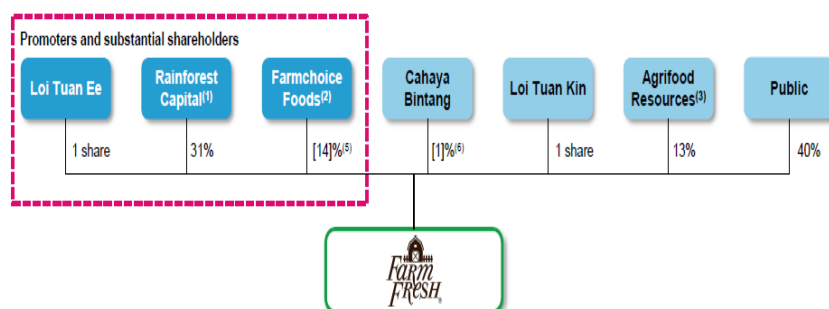
Farm Fresh (FF) is a young and high-growth integrated dairy group, which is engaged in farming, manufacturing and distribution of dairy products and plant-based products. Presently, the vast majority of its raw milks produced through farming are earmarked for internal manufacturing requirements. Therefore, in terms of external sales, chilled RTD milk and ambient RTD milk contribute the bulk of FF's FY21 revenue at 46% and 31% respectively. The group has c.135 single keeping units (SKUs), marketed under brands such as Farm Fresh, Master Barista, Yarra Farm and etc.

Currently, the group's primary operations are located in Malaysia and Australia. FF has 5 dairy farms and 2 processing facilities (Muadzam Shah and Larkin) in Malaysia alongside 1 farm and 1 processing facility (Kyabram) in Australia. Given that Australia is one of the key milk producing countries globally, FF's operations in Australia provides the group an added advantage in terms of input procurement, specifically frozen fresh milk, which is the key ingredient to make FF's dairy products fresher and more flavourful. We reckon it is challenging to source fresh milk if one is not fully integrated as reflected in the Malaysian dairy environment where majority of other dairy corporations tend to import milk powder instead of fresh milk.

In addition, FF owns AFS Dairy Company Australia, an Australian Friesian Sahiwal (AFS) gene bank, which allows the group to modify and optimise genetic features of cow to a breed that can optimally and resiliently produce high milk yield in tropical countries. Note that, FF's Malaysian cows are mainly AFS and Jersey Friesian crossbreed, whereas Australian cows are pure Holstein breed.

Separately, Khazanah, a key early investor of FF that acquired 30% stake in 2011 through Agrifood Resources was also pivotal to FF's success as its supports have helped FF in establishing Muadzam Shah farm, which became fully operational in 2014. Although Khazanah's stake is expected to be pared down to 13% post IPO assuming no over allotment (refer to Exhibit 1), we note that many new institutional investors would be on-boarded post-IPO. Meanwhile, the promoters, comprising of Loi Tuan Ee, Rainforest Capital and Farmchoice Foods would remain as FF's substantial shareholders with combined equity stake of 45%.

Exhibit 1: Post-IPO Shareholding Assuming no Over-Allotment



Note:

(1) Ultimate beneficial owners are Loi Tuan Ee, Loi Tuan Kin and Loi Foon Kion

(2) Ultimate beneficial owners are Loi Tuan Ee, Loi Tuan Kin, Azmi Bin Zainal, Adam Graeme Petty and Mawai Capital (combined stake of 87.6%) with balance owned by Cahaya Bintang (12.4% stake)

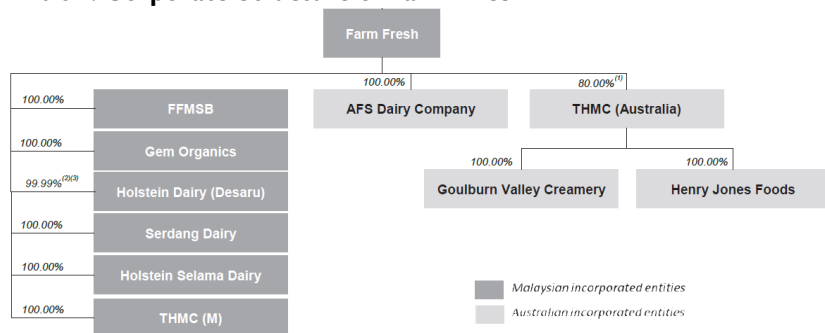
(3) Ultimate beneficial owner is Khazanah Nasional

(5) Excluding 1.27% equity interest in Farm Fresh, to be declared as dividend-in-specie to Cahaya Bintang

(6) Following declaration of dividend-in-specie by Farmchoice Foods resulting in 1.27% equity stake held.

Source: Company

Exhibit 2: Corporate Structure of Farm Fresh



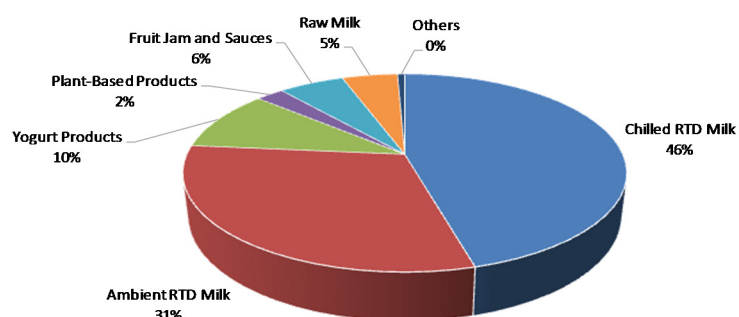
Note: (1) Remaining 20% held by Dairy Livestock Export Pty Ltd which belongs to Adam Graeme Petty.

(2)(3) Loi Tuan Ee and Azmi Bin Zainal hold one share each in Holstein Dairy (Desaru)

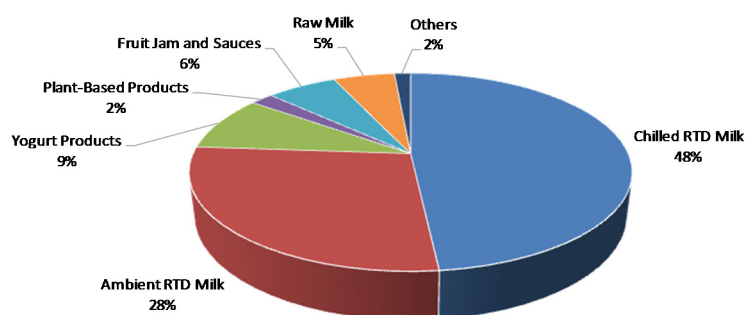
Source: Company

Exhibit 3: Products Revenue Breakdown

FY21



1HFY22

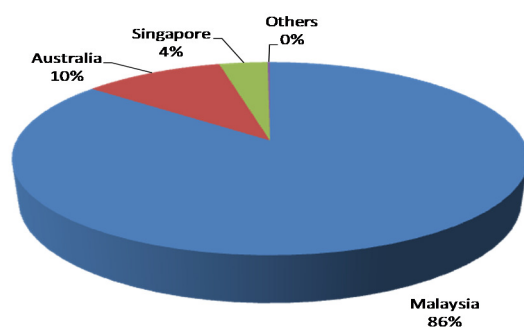


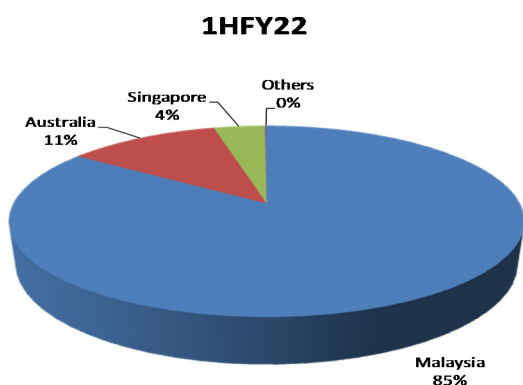
Note: Stopped selling raw milk to third party since September 2021

Source: Company, TA Securities

Exhibit 4: Geographical Revenue Breakdown

FY21





Source: Company, TA Securities

Exhibit 5: Dairy Cow and Raw Milk Output

FYE March	FY19	FY20	FY21	1HFY22	10MFY22
Malaysia					
Total Milking Cow	1226	1503.0	1767.0	2105.0	2226.0
Total Milk Output (mn litres)	6.8	7.9	8.9	5.4	10.0
Milk Yield (litre/day)	15.2	14.4	13.8	14.0	14.7
Australia					
Total Milking Cow	1001	1296.0	1242.0	1209.0	1232.0
Total Milk Output (mn litres)	11.7	15.9	13.8	6.7	11.2
Milk Yield (litre/day)	32.1	33.7	30.5	30.2	29.8

Source: Company, TA Securities

Exhibit 6: Dairy Plant Capacity and Utilisation

FYE March	FY19		FY20		FY21		1HFY22		10MFY22	
	Capacity (mn litres)	Utilisation (%)	Capacity (mn litres)	Utilisation (%)	Capacity (mn litres)	Utilisation (%)	Capacity (mn litres)	Utilisation (%)	Capacity (mn litres)	Utilisation (%)
Finished Products										
Muadzam Shah	28.6	26.8	46.4	47.8	56.9	67.3	34.6	57.8	59.3	57.6
Larkin	42.6	47.8	52.6	40.3	52.6	72.9	31.4	65.3	52.3	63.0
	71.2	39.3	99.0	48.6	109.5	70.0	65.9	61.4	111.6	60.1
Processed Milk										
Kyabram					38.5	56.0	42.0	52.3	70.0	54.5

Source: Company, TA Securities

Exhibit 7: IPO Structure

Categories	Number of shares (m)	% of new shares	% of enlarged share cap
Retail Offering			
Malaysian public (for ballot)	18.6	2.5%	1.0%
Bumi allocation (for ballot)	18.6	2.5%	1.0%
Eligible directors and employees	18.6	2.5%	1.0%
Institutional Offering	455.2	61.2%	24.5%
Identified Bumi Investors	232.2	31.3%	12.5%
Approved by MITI			
Total	743.2	100.0%	40.0%
in which:			
New share issuance	223.0	30.0%	12.0%
Existing shares offer for sale	520.2	70.0%	28.0%

Source: Company, TA Securities

Utilisation of Proceeds

The estimated gross proceeds of RM301.0mn raised are expected to be utilized in the following manners:

Exhibit 8: Utilisation of Proceeds

Details	Amount (RM'mn)	% of Proceed
New Malaysian Manufacturing Hub		
- Land Acquisition	30.0	10.0
- Building Construction	20.0	6.6
- Machinery and Equipment	40.0	13.3
New Malaysian Farm and Processing Facility	50.0	16.6
Expand Australian Production Facility	60.0	19.9
Regional Expansion	40.0	13.3
Working Capital	40.8	13.6
Estimated Listing Expense	20.2	6.7
	301.0	100.0

Source: Company, TA Securities

Investment Merits

1) Leading Integrated Dairy Group

The group has significant expertise along the industry's value chain, from farming, manufacturing to distribution of dairy products and plant-based products. We believe FF's in-house farming herd capacity of c.9.7k and operations in Australia provide the group an added advantage in terms of input procurement, specifically fresh milk, which is the key ingredient to make FF's dairy products fresher and more flavourful alongside one of the key reasons for FF's success in Malaysia. Moreover, the recent acquisition of Australian Kyabram facility empowers the group to process raw milk from its Greater Shepparton farm and other Australian third party farms before being shipped to Malaysia for further processing. Such vertical integration allows FF to internalize more processes along the value chain, reduce third-party reliance and lift profitability of the group's business.

FF is identified as one of the largest and fastest growing integrated producer of dairy products in Malaysia where its market share of chilled RTD milk and yogurt has increased from c.12% and c.5% respectively in CY15 to c.42% and c.11% respectively in 9MCY21. Besides, the group's ambient RTD milk category has also demonstrated tremendous growth since its entry in 2QCY18 where it now commands c.10% market share as of 9MCY21. In addition, it is worth noting that FF is the market leader in the fresh milk sub-segment of chilled RTD milk and ambient RTD milk at c.54% and c.48% market share respectively, and this reflects FF's ability to displace Malaysian dairy market by using fresh milk instead of milk powder.

Exhibit 9: Market Share based on Malaysian Dairy Product Category

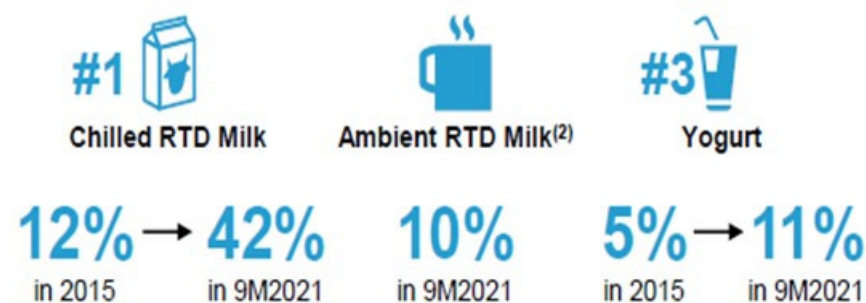
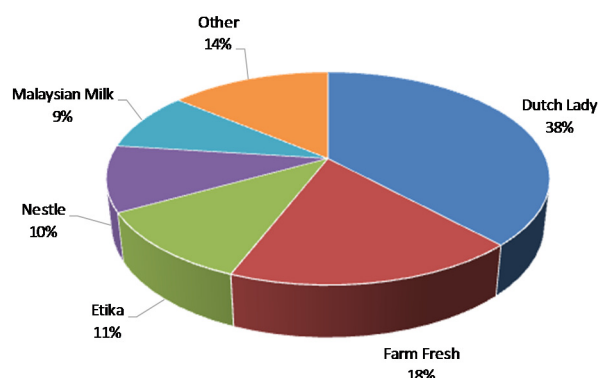
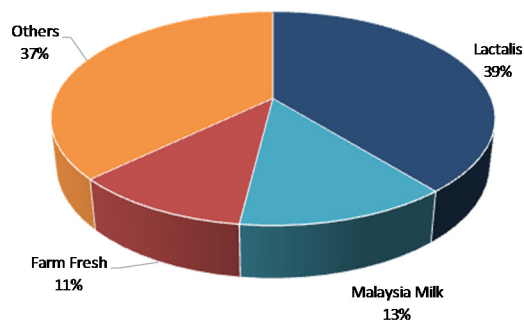


Exhibit 10: Market Share of Key Players in Malaysian RTD Milk



Source: Company, TA Securities

Exhibit 11: Market Share of Key Players in Malaysian Yogurt

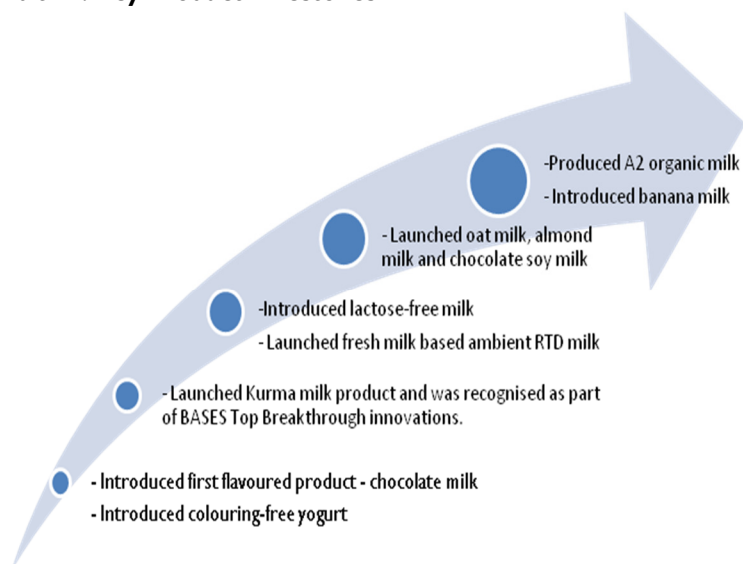


Source: Company, TA Securities

2) Recognised Brand Built on Fresh Milk Proposition

FF is the only integrated dairy company in Malaysia that produces RTD milk and yogurt without using reconstituted milk or milk powder sources for its own Farm Fresh branded products. Such commitment in fresh milk-based products has delivered a differentiated taste in the group's product and has generated positive brand recognition among consumers. Besides that, the group has c.135 SKUs of products catering to different preferences (i.e., product shelf life, low fat milk, full cream milk and flavoured milk), dietary restrictions (i.e., vegan and lactose-intolerant), and functional requirements (i.e., kurma milk, tongkat ali and organic milk).

Exhibit 12: Key Product Milestones



Source: Company, TA Securities

3) Extensive Multi-Channel Distribution Network

FF is unique compared to most of its competitors for having the network of stockiest and home dealers, as a complement to more commonly used distribution channel networks such as large format retailers, HORECA market, export market and convenience stores. Such extensive multi-channel distribution network strategy has allowed FF to effectively facilitate sales of different products to different customers. For instance, working with large format retailers allow FF to sell its products to end consumers through retailers' premises that are typically located in established townships with high population. Meanwhile, stockist and home dealers, which leverage on 'word-of-mouth', provides FF with better product penetration in more remote areas. For FY21, the large format retailer was the highest sales contributor to FF, at 44% of group's sales whereas stockiest and home dealer were the fastest growing channels, which sales contribution increased from 19% in FY19 to 35% in FY21.

Exhibit 13: Revenue % Breakdown by Distribution Channel

FYE March	FY19	FY20	FY21	1HFY21	1HFY22
Large Format Retailer	59.2	44.7	44.1	44.2	46.5
Stockist and Home Dealers	19.2	29.6	34.5	33.7	30.5
HORECA Market	16.9	19.2	14.8	15.0	16.0
Export Markets	4.2	3.5	3.8	4.3	4.2
ConvenienceStores	0.5	3.0	2.8	2.8	2.8

Source: Company, TA Securities

Industry Outlook

1) Strong Dairy Demand Growth in Southeast-Asia Region

The total size of RTD milk, yogurt and RTD plant-based milk in Malaysia has grew at a remarkable CAGR of 11.1% to RM2.84bn in CY20 from RM1.68bn in CY15. The growth was primary led by RTD milk, which lion share of 74% was contributed by ambient RTD milk (milk that does not need to be chilled i.e., UHT milk and sterilized milk which tend to have longer shelf life) and balance 26% contributed by chilled RTD milk (milk that need be stored under chilled condition of <5°C along the supply chain).

Reference to Frost and Sullivan, the demand growth for RTD milk, yogurt and RTD plant-based milk in Malaysia during the period of CY21-25 are expected to remain robust at c.8% CAGR supported by i) increasing consumer awareness over nutrient-rich milk products, ii) increasing disposable income and iii) population growth. This is particularly true in emerging markets i.e., Malaysia, Philippines and Indonesia, which consumption of milk and milk products per capita of 54kg, 23kg and 17kg respectively are significantly lower than the consumption in the developed market i.e., United States and Australia, which consume 276kg and 297kg per capita respectively. Therefore, there is abundance of opportunity for FF in Malaysia and Southeast-Asia region, which remain underpenetrated at this juncture.

Exhibit 14: Size and Growth of Malaysian RTD Milk, Yogurt and Plant-Based Milk

	2015	2020	2025F	2015-2020 CAGR	2021F-2025F CAGR
RTD MILK	1114.4	2086.5	2884.0	13.4%	8.7%
Chilled	317.2	539.5	780.6	11.2%	10.0%
Ambient	797.2	1547.0	2103.4	14.2%	8.3%
Yogurt	313.7	438.9	567.4	6.9%	6.9%
Drinking	155.3	210.6	272.8	6.3%	6.8%
Edible	158.4	228.3	294.6	7.6%	7.0%
RTD Plant-Based Milk	252.2	315.1	392.5	4.6%	5.5%
Total	1680.3	2840.5	3843.9	11.1%	8.1%

Source: Frost and Sullivan, TA Securities

2) Growing Milk Supply in Malaysia

The Malaysian Agriculture and Food Industry Ministry is committed in boosting the country's dairy sector to achieve 100% self-sufficient level for fresh raw milk. There were several new dairy valleys outlined under the 12th Malaysia Plan across Melaka, Johor, Sabah, Sarawak, Kelantan and Terengganu. Addition of these new dairy valleys to existing five operational dairy valleys are expected to lift Malaysian raw milk supply and better support the fast growing local dairy demand. Besides, advancement in superior genetics of cows, technology in facilities and perfection of herd management will continue to improve operational environment for dairy farmers. For example, average milk yield per lactation cycle in Malaysia has increased from 2.5k litres in CY16 to 3.2k liters in CY20, representing a CAGR of 6.2%.

Exhibit 15: Location of Existing and Proposed Dairy Valleys in Malaysia



Source: Company, TA Securities

Key Risks Relating to Business and Industry

1) Food Safety, Product Quality and Product Certification

Safe food handling is crucial for the group as any actual or perceived contamination or deterioration in product quality may lead to product recall, damaged reputation and dented financial performance. Moreover, the group is required to obtain various certifications from government authorities and regulatory agencies before making claims and selling products. Therefore, inability to obtain or renew necessary certifications for products would adversely impact business operations.

2) Price Fluctuation and Availability of Raw Materials

Raw milks, packaging materials alongside animal feeds and herd health cost make up 49%, 24% and 11% of the group's raw material cost respectively. Their prices are largely subject to dynamic of supply and demand. Any unfavourable fluctuations in the price or shortage in the global market will exert upward pressure on production cost.

3) Foreign Exchange Risk

Given that majority of sales are denominated in Ringgit, and about one-quarter of purchases are denominated in AUD and USD, the depreciation of ringgit against foreign currency could affect the bottom line of the group. Nonetheless, the fluctuation in foreign exchange rates is monitored closely by FF, in which forward contract is strategically used to manage its net exposure.

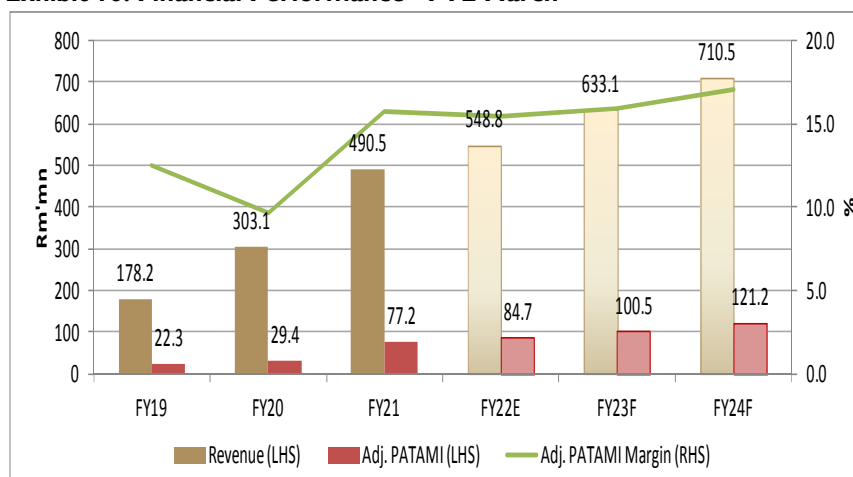
4) Vulnerability to Diseases

Outbreak of bovine diseases could negatively affect productivity of farm, specifically milk yield, milk quality and herd size alongside consumers' demand for milk. Furthermore, insurance coverage over biological assets is unavailable commercially. Nevertheless, the group implements various insecurity measures within farms to minimize possibility and severity of diseases outbreak.

Financial Highlights

Profit and Loss Statement

Exhibit I6: Financial Performance - FYE March



Source: Company, TA Securities

After stripping out exceptional item such as additional tax liability, impairment of PPE and one-off redundancy cost, FY21 adj. PATAMI of RM77.2mn was more than triple of FY19 adj. PATAMI of RM22.3mn. The remarkable earning growth is attributed to i) higher FY21 revenue, which has nearly tripled from FY19 to RM490.5mn in FY21 underpinned by ramp-up in the output of

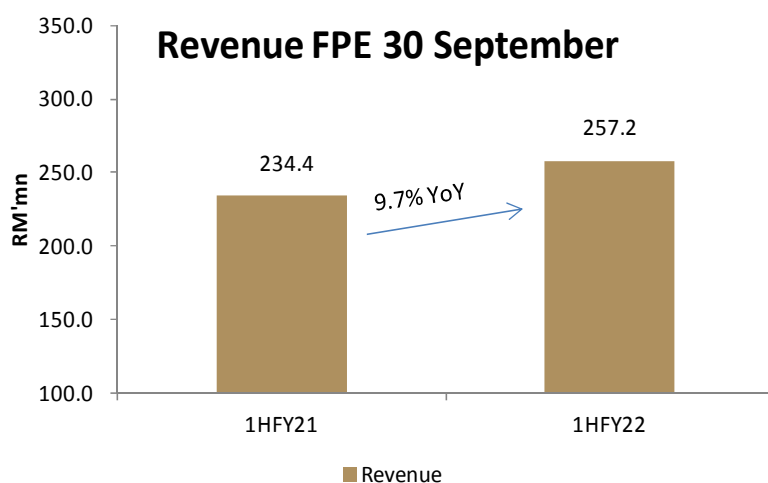
Malaysian finished milk products to 76.6mn liters (+174%) alongside ii) lower adj. effective tax rate owing to statutory tax exemption for Larkin facility starting from FY21. Ambient RTD milk, which was newly introduced by FF in FY19 has led the group's sales growth, contributing revenue of RM150.1mn in FY21, which was up RM138.1mn compared to FY19.

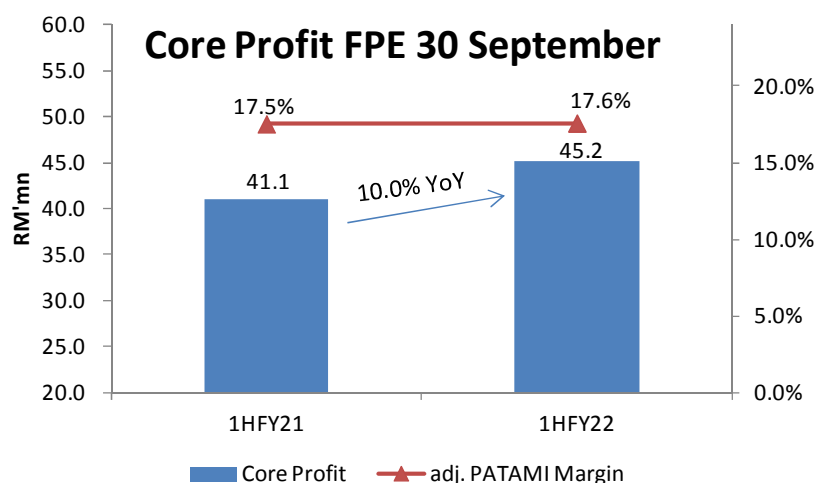
With regards to GP Margin, the fall in FY20 to 26.4% was mainly due to low utilisation rate in Muadzam Shah plant following significant capacity expansion which led to temporal diseconomies of scale. Nonetheless, GP margin ticked up by 2.3%-pts in FY21 to 28.7% owing to pick up in utilisation rate of Muadzam Shah plant and favourable portfolio shift towards ambient RTD milk which carried higher GP margin. As a result, the growth quantum of adjusted PBT in FY20 was relatively small at 31.6% YoY before surging 163% YoY in the following year to RM72.4mn in FY21.

Reported effective tax rate in FY21 surged to 51.4% from 5.0% in FY20 and 2.9% in FY19. This was mainly due to additional tax liability of RM25.7mn payable for FY14-20 but recognised in FY21 alongside tax incurrence of RM10.5mn in FY21, which will be then reversed in FY22 upon receipt of the 5+5 years statutory tax exemption for Larkin facility. Nonetheless, in our financial model, we have made adjustments to account for the tax changes and thus resulted in FY19/20 adj. effective tax rate of 21% and adj. effective tax income of 2% in FY21.

1H FY22 revenue grew by another 9.7% YoY after remarkable 62% YoY growth in prior year which was partly boosted by consumer panic buying upon first introduction of nationwide movement restriction. Meanwhile, the core profit increased by 10.0% YoY as the increase in packaging material cost and freight charges alongside negative GP margin incurred by Australian fruit jam operations were mitigated by reduction in selling and distribution expenses as FF held back on promotional campaign owing to the lockdown restrictions. FF reported a tax income of RM14.3mn in 1H FY22 primarily due to reversal of tax payable for FY21 after receiving approval from the Ministry of Finance that Larkin facility is exempted from statutory income starting from FY21. Nonetheless, we have made the necessary adjustment in our 1H FY22 core earnings to strip off the implication of aforementioned tax reversal.

Exhibit 17: Financial Performance - 1H FY22 vs 1H FY21





Source: Company, TA Securities

Balance Sheet

On the balance sheet front, the group's FY21 net gearing increased to 0.96x (against 0.35x and 0.71x in FY19 and FY20 respectively) mainly attributed to higher working capital financing correspond to growing size of business alongside higher drawdown for plant and farm investment. We are comfortable of the gearing level as FF would turn into a net cash position upon receipt of IPO proceeds and the group's interest coverage is healthy at c.9x.

With regards to liquidity, current ratio and quick ratio deteriorated to 0.79x and 0.38x in FY21 from 1.34x and 0.82x in FY19; nonetheless, this is temporary as the ratio would improve substantially upon receipt of IPO proceed.

Overall asset turnover has increased to 0.79x in FY21 (against 0.65x and 0.73x in FY19 and FY20 respectively) reflecting general improvement in asset efficiency. However, cash conversion cycle has seemingly increased, to c.89 days in FY21 from 68 days in FY19, mainly due to higher days of inventory outstanding and lower days of payables outstanding.

Exhibit 18: Financial Position Ratio

	FY19	FY20E	FY21F	FY22F	FY23F	FY24F
Net Gearing (x)	0.35	0.71	0.96	Net Cash	Net Cash	Net Cash
Current Ratio (x)	1.34	1.18	0.79	3.01	2.97	3.02
Quick Ratio (x)	0.82	0.81	0.38	2.40	2.35	2.39
Asset Turnover (x)	0.65	0.73	0.79	0.53	0.56	0.58
Cash Conversion Cycle (days)	68.3	81.4	89.0	85.8	82.8	79.9

Source: Company, TA Securities

Future Plans and Business Strategies

1) Expansion on Farming and Plant Capacity

C.RM200mn of proceeds raised is expected to be allocated for expanding farm capacity (scale up farm area, herd size and milk production) and plant capacity (increase chilled RTD milk and ambient RTD milk product capacity alongside set up new ice cream production capacity). Following the series of expansion plans, FF's farming capacity is estimated to increase by 84% to c.17.8k herd capacity; Malaysian annual production milk capacity is estimated to increase by 47% to 201mn liters; and Australian facility is expected to be equipped with additional 50mn liters of ambient RTD milk capacity.

Some of the upstream farming expansions include expanding Taiping farm to herd capacity of c.3.3k from 1.4k currently; new dairy farm in East Malaysia with herd capacity of c.3.0k upon full completion; and potential plan of expanding Muadzam Shah herd capacity to c.5.6k from 3.1k currently. Meanwhile, midstream plant expansions in Malaysia include expanding Muadzam Shah facility by 5.7mn liters of milk capacity (commence Apr-22); setting up new processing facilities in UPM with 3.3mn liters of chilled RTD milk capacity (commence Mar-22); establishing new Taiping facility with 20.8mn liters of chilled RTD milk capacity (commence Jun-22), constructing new manufacturing hub in Central Peninsula with 13.6mn liters of ambient RTD milk capacity and 2.3mn kg of ice cream capacity (completion in 2HCY24), alongside setting up new processing facility in East Malaysia with 20.8mn liters of chilled RTD milk capacity (completion in 1QCY24). Separately, Australian Kyabram facility would be installed with 50mn liters of ambient RTD milk capacity to serve as an export hub to Asia-Pacific region whereas Indonesia and Philippines would each be installed with milk processing plant with capacity of c.20.8mn liters upon FF establishing more market presence in respective countries.

2) Products and Packaging Innovation

The group is not resting on its laurels and is committed to develop new product categories and new innovation to excite the consumers. One of the new product categories which FF aims to introduce in CY22 is the growing-up milk for kids aged from 3 to 12 years old, in which the group intends to use fortified fresh milk formula that has better nutritional values to displace current Malaysian powdered milk market (estimated market value of RM2.3bn), which primarily offers powder-based kids milk and RTD reconstituted milk-based products. Moreover, the group has also set plans to launch plant-based yogurt products and ice cream in the future. In regards to packaging, FF plans to introduce 125ml packaging variant to cater for kids and penetrate the schools in Malaysia. We reckon such strategy is a very powerful move given that brand recognition and awareness instilled in the early days of an individual tend to be more personal and would last for a long time.

3) New Regional Market Expansion

C.RM40mn of proceeds raised is earmarked to develop production and distribution capability regionally, specifically Indonesia and Philippines. According to Frost and Sullivan, value of RTD milk in Indonesia and Philippines are equivalent to c.RM6.5bn and c.RM0.8bn in CY20 and are expected to grow at CAGR of 9.3% and 6.5% over the period CY20-25. Therefore, this presents FF with a large addressable market that has cultural similarities to Malaysia which FF has proven to be successful.

ESG Consideration

The group's sustainability efforts are anchored around three focus areas, namely quality dairy, stronger communities and healthier planet.

Being the founding mission, which resulted in the establishment of FF, the group is committed in producing healthy fresh quality dairy products that are free from preservatives and colourings alongside provide balanced nutritional value to consumers. This correspondingly requires the group to place high emphasis over animal health and welfare by meeting objective standards for the humane treatment of farm animals. Although there could be risk of protest by animal right activities against dairy farming, we note that FF's farms were

one of the first farms in Asia to attain the internationally-recognised Certified Humane Raise and Handled Humane certifications.

As for stronger communities, the group strives to offer employment opportunities to rural and indigenous demographics and encourage sub-urban micro-entrepreneurship via its home dealership network. Moreover, FF works closely with partner farmers by purchasing raw milk from them at fair market prices and transfer technical knowledge to them through mentorship. The group also takes part in Malaysian Ministry of Education's Supplementary Food Programme by supplying milk packets to primary school students from rural areas and low-income households.

Acknowledging that dairy farming is one of the key contributors to global greenhouse gas emission, the group has set target to reduce its emission by 25% in 5 years via rooftop solar PV projects, bio-gas plant and other carbon reduction initiatives. On a positive note, Farm Fresh's Malaysian and Australia farms are reported to generate 27% and 47% less emission of greenhouse gas than average Asian and Oceania peers. Besides, the group practice regenerative agriculture and water management alongside spearhead sustainable packaging by using fully recyclable paper packaging for its ambient products.

Dividend Policy

The group has a target payout ratio of 25%, which we deem sustainable and reasonable considering the company is in a high growth stage and reinvesting for expansion is the key for success. Based on our forecast, FF is expected to reward DPS of 1.1/1.4/1.6sen to shareholders in FY22/23/24, translating into 0.8/1.0/1.2% dividend yield.

Earnings Forecast

We estimate the group to record earnings growth of 9.7/18.6/20.6% YoY to RM84.7/100.5/121.2mn for FY22/23/24 (3-year CAGR of 16.2%). The growth is led by top-line growth driven by higher production volume supported by aggressive plant capacity expansion alongside improvement in ASP following price hike on chilled RTD milk effective Sep-21 and ambient RTD milk effective Dec-21.

Our projections are premised on the assumptions below:

- Total finished milk product capacity to increase to 251mn liters by end of 2024 from 137mn liters currently supporting low double-digit output growth across the years. Our FY22 utilization rate is projected to be c.60%.
- We expect GP margin to bounce higher compared to 25.5% registered in 1HFY22 owing to i) price increase implemented in 2HFY22, ii) internalizing raw milk processing from Greater Shepparton farm and third party farm through Kyabram facility alongside internalizing raw milk production from various farm expansions and iii) uptrading towards plant-based RTD milk which carry higher GP margin. All in, out FY22/23/24 GP margin is estimated at 28/31/32% compared to 29% achieved in FY21.
- Given that the group has tax incentives for Larkin and Muadzam Shah facilities, we estimate the group's effective tax rate to be at c.10% in FY23/24. Note that, the group would not be subjected to Cukai Makmur.

Exhibit 19: Summary of Tax Incentives

Farm/Facility	Details of Incentives	Awarding Ministry	Expiry
Larkin Facility	100% income tax exemption for qualifying activities under Section 127, Income Tax Act 1967	MOF	2025, extendable to 2030
Muadzam Shah Facility	100% income tax exemption for qualifying activities under Special ECER Incentive Programme.	MIDA	2024, extendable to 2029
Mawai Farm Larkin Facility	100% income tax exemption for qualifying activities under Section 127, Income Tax Act 1967	MAFI	2023

Source: Company, TA Securities

Valuation

For reference, listed companies in Bursa Malaysia that have sizeable dairy products manufacturing exposure are Nestle, F&N, Dutch Lady and Able Global which are traded at PER of 55x, 23x, 22x and 11x respectively and an average of 28x. Meanwhile, another large cap food manufacturing company with established farming and food manufacturing capability i.e., QL resources is traded at PER ratio of 64x.

We believe FF should be valued at 28x CY23 PER which is the average PER ratio of companies with dairy products manufacturing capacity. While this is c.25% higher than traded valuation of F&N and Dutch Lady, it remains substantially discounted compared to Nestle, at c.50% discount.

We reckon such valuation is justified considering that i) FF has proven to be successful in eating into market share of Dutch Lady with its fresh milk proposition, ii) ability to expand regionally which presents large addressable market and iii) robust expansion plan across Malaysia and Australia. Meanwhile, we attribute our discount against Nestle to extensiveness of product as Nestle products are very close to the heart of Malaysian consumers.

Based on IPO price of RM1.35/share, FF will be listed at a forward CY23 PER of 21.6x, a c.29% discount to our targeted PER of 28x. As such, we initiate coverage on FF with a Buy recommendation and a target price of RM1.75 (based on 28x CY23 PER).

Exhibit 20: Peer Comparison

Company	Share Price (RM)	Market Cap (RM'mn)	Adj. EPS ^ (sen)	PE (x)	DPS ^ (sen)	Div Yield (%)	Net Gearing (x)	PB (x)
<u>Dairy Product Manufacturing</u>								
Nestle	135.40	31751	247	55	242.0	1.8	0.6	54.5
F&N	22.26	8161	96	23	60.0	2.7	Net Cash	2.9
Dutch Lady	32.24	2063	146	22	50.0	1.6	Net Cash	5.4
Able Global	1.43	444	13	11	5.0	3.5	Net Cash	1.1
Average				28		2.4		16.0
<u>Farming and Food Manufacturing</u>								
QL Resources	4.80	11682	8	64	3.5	0.7	0.4	4.9
Farm Fresh *	1.35	2508	4	31	1.1	0.8	Net Cash	4.5

Note: * based on pro-forma balance sheet

^ based on 12-month trailing

Source: Company, Bloomberg, TA Securities

Exhibit 21: Earnings Summary
Profit and Loss Statement

FYE Mar (RMmn)	2020	2021	2022E	2023F	2024F
Revenue	303.1	490.5	548.8	633.1	710.5
EBIT	42.6	77.3	94.4	117.1	142.8
Net finance cost	(6.4)	(9.8)	(10.5)	(7.7)	(7.2)
EI	5.9	(41.0)	5.6	0.0	0.0
PBT	36.2	67.6	83.9	109.5	135.6
Taxation	(1.8)	(34.8)	4.2	(10.9)	(16.3)
MI	0.8	3.4	2.2	2.0	1.8
Net profit	35.2	36.2	90.3	100.5	121.2
Core net profit	29.4	77.2	84.7	100.5	121.2
Core EPS (sen)	1.6	4.2	4.6	5.4	6.5
DPS (sen)	0.0	0.0	1.1	1.4	1.6
Book value (RM)	0.1	0.1	0.3	0.4	0.4
NTA (RM)	0.1	0.1	0.3	0.4	0.4

Ratios

FYE Mar (RMmn)	2020	2021	2022E	2023F	2024F
Valuations					
Core PER (x)	85.5	32.5	29.6	25.0	20.7
Div. yield (%)	0.0	0.0	0.8	1.0	1.2
P/BV (x)	12.7	10.4	4.2	3.7	3.3

Profitability ratios

EBITDA margin (%)	18.7	21.1	22.6	22.9	24.5
PBT margin (%)	11.9	14.8	16.2	17.3	19.1
Core net margin (%)	9.7	15.7	15.4	15.9	17.1
Core ROE (%)	16.9	36.4	20.4	15.8	16.9
Core ROA (%)	8.5	14.9	10.2	9.3	10.5

Liquidity ratios

Current ratio (x)	1.2	0.8	3.0	2.9	3.0
Quick ratio (x)	0.8	0.4	2.4	2.3	2.3

Leverage ratios

Equity/total liabilities (x)	0.9	0.6	1.4	1.5	1.7
Net debt / equity (x)	0.7	1.0	Net Cash	Net Cash	Net Cash

Growth ratios

Revenue (%)	70.0	61.8	11.9	15.4	12.2
PBT (%)	28.4	86.8	24.1	30.5	23.9
Core net profit (%)	31.6	163.2	9.7	18.6	20.6

Balance Sheet

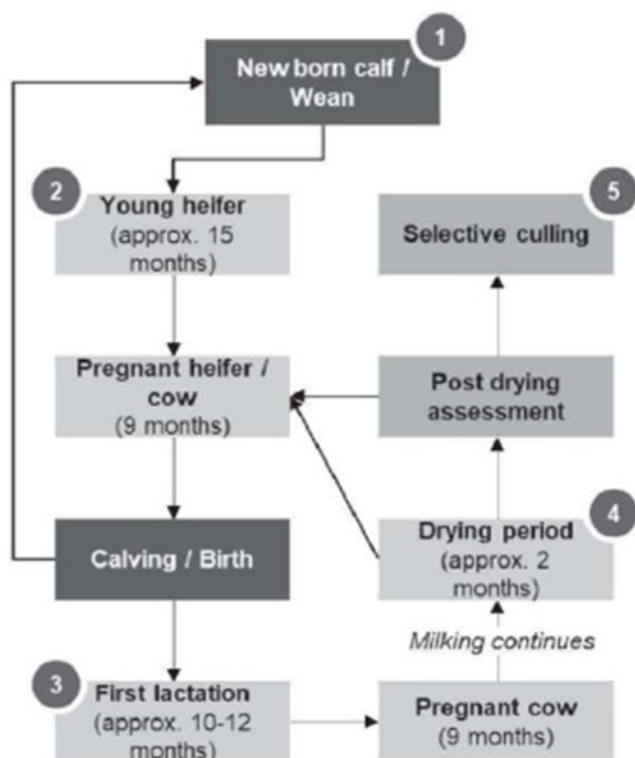
FYE Mar (RMmn)	2020	2021	2022E	2023F	2024F
PPE	198.9	307.1	354.0	407.5	457.8
Intangible asset	13.9	19.9	19.9	19.9	19.9
Biological asset	55.7	69.5	78.2	86.6	94.8
Others	15.9	20.3	21.3	22.2	23.1
Non-current assets	284.4	416.7	473.4	536.2	595.5
Inventories	40.2	105.0	114.8	123.5	131.5
Trade receivables	81.0	88.8	99.3	114.6	128.6
Cash and bank balance	7.5	11.7	356.8	335.2	344.4
Others	0.0	0.0	0.0	0.0	0.0
Current assets	128.7	205.6	571.0	573.3	604.5
Total assets	413.0	622.3	1,044.4	1,109.6	1,200.0
LT borrowings	90.1	101.0	233.6	217.6	209.6
Others	15.9	18.7	20.4	21.9	23.3
Non-current liabilities	106.0	119.7	253.9	239.5	232.9
Trade payables	50.0	83.1	93.6	103.6	113.4
ST borrowings	58.5	140.9	58.4	54.4	52.4
Others	0.7	37.5	37.7	37.9	38.1
Current liabilities	109.3	261.5	189.7	195.9	203.9
Shareholders funds	189.3	234.6	596.6	672.0	762.9
MI	8.5	6.4	4.2	2.2	0.4
Total equity	197.8	241.0	600.8	674.2	763.3
Total E&L	413.0	622.3	1,044.4	1,109.6	1,200.0

Cash Flow Statement

FYE Mar (RMmn)	2020	2021	2022E	2023F	2024F
Pretax profit	36.2	67.6	83.9	109.5	135.6
Depreciation	13.9	21.4	24.6	28.1	31.5
Net interest	6.4	9.8	10.5	7.7	7.2
Changes in WC	(30.2)	(40.0)	(18.6)	(22.3)	(20.3)
Tax	(0.0)	(0.1)	4.2	(10.9)	(16.3)
Others	(2.1)	0.9	0.0	0.0	0.0
Operational cash flow	24.2	59.7	104.5	112.0	137.6
Capex	(84.6)	(75.1)	(70.0)	(80.0)	(80.0)
Interest income	0.0	0.2	0.5	4.0	4.0
Others	(7.4)	(10.8)	0.0	0.0	0.0
Investing cash flow	(92.0)	(85.7)	(69.5)	(76.0)	(76.0)
Net share issue	0.0	0.0	292.9	0.0	0.0
Net borrowings	37.0	31.5	50.0	(20.0)	(10.0)
Dividend paid	0.0	0.0	(21.2)	(25.1)	(30.3)
Interest paid	(5.3)	(6.8)	(11.0)	(11.7)	(11.2)
Others	33.1	(0.1)	(0.7)	(0.8)	(0.9)
Financial cash flow	64.8	24.5	310.0	(57.6)	(52.4)
Net cash flow	(3.0)	(1.5)	345.0	(21.6)	9.3
Beginning cash	(0.8)	(0.5)	(2.5)	342.5	320.9
Forex & others	3.3	(0.6)	0.0	0.0	0.0
Ending cash	(0.5)	(2.5)	342.5	320.9	330.2

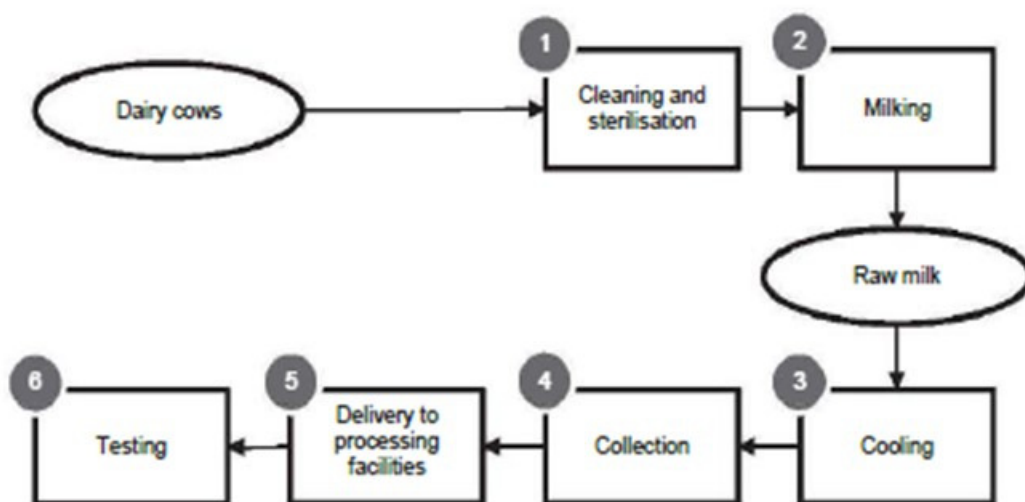
Appendix

Appendix 1: Lifecycle of Milking Cow



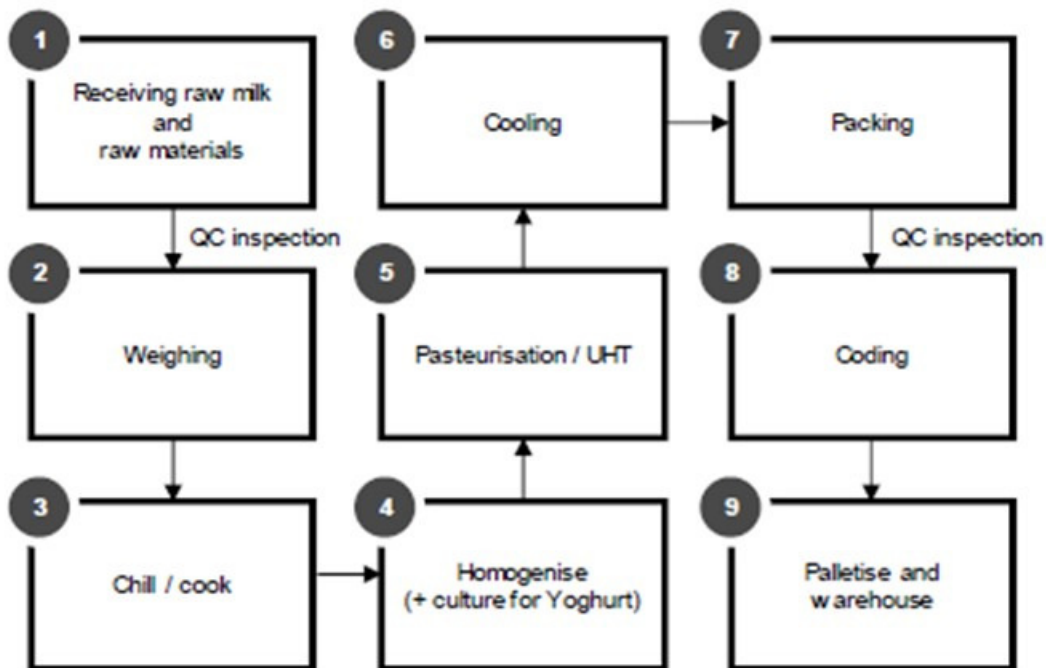
Source: Company

Appendix 2: Process Flow of Milking Process



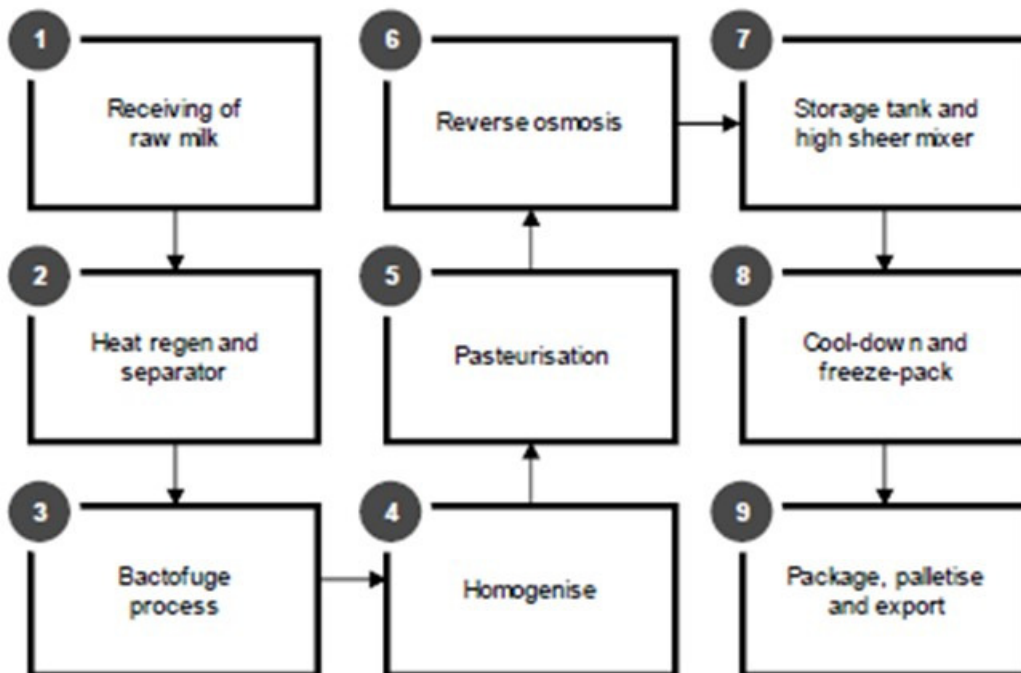
Source: Company

Appendix 3: Process Flow of Further Processing into Finished Dairy Products



Source: Company

Appendix 4: Process Flow of Kyabram's Raw Milk Processing



Source: Company

Appendix 5: Brands and Key Products

Product category / Revenue contribution ⁽¹⁾⁽²⁾		Brands	Key products				
Chilled RTD milk	46%	FARM FRESH Yarra MASTERS BARISTA Nubian Goats HENRY JONES	Full Cream Milk	Skinny Milk	Lactose Free Milk	Lactose Free Skinny	Skimmed Milk
			Full Cream Milk	Low Fat Milk	Master Barista Full Cream Milk	Nubian's Goat Milk	Organic A2 Protein Milk
			Chocolate Milk	Café Latte	Kurma Milk	Banana Milk	
UHT / ambient products	31%	FARM FRESH Yarra HENRY JONES	Full Cream Milk	Chocolate Milk	Kurma Milk	Café Latte	Café Latte Tongkat Ali
			Yarra Full Cream	Master Barista Full Cream Milk	Australian Low Fat Milk	A2 Protein Milk	Banana Milk
Yogurt products	10%	FARM FRESH Yarra	Mixed Berries, Strawberry, Mango, Lychee, Fruit Punch, Original Yogurt Drink	Skinny Yogurt	Full Cream Yogurt	Farm Yogurt	Greek Yogurt
							Natural Yogurt
Plant-based products	2%	FARM FRESH	Soy Milk – Original & Unsweetened	Oat Milk	UHT Soy Milk – Original	Chocolate Soy Milk	Almond Milk
							UHT Oat Milk
Fruit jam & sauces	6%	IXL Taylor's	Variety Flavored Jam	Variety Flavored Gourmet Marinades, Sauces and Mayonnaise			

Note: Revenue contribution based on FY21

Source: Company

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Stock Recommendation Guideline

- BUY** : Total return within the next 12 months exceeds required rate of return by 5%-point.
HOLD : Total return within the next 12 months exceeds required rate of return by between 0-5%-point.
SELL : Total return is lower than the required rate of return.
Not Rated: The company is not under coverage. The report is for information only.

Total Return is defined as expected share price appreciation plus gross dividend over the next 12 months. Gross dividend is excluded from total return if dividend discount model valuation is used to avoid double counting.

Required Rate of Return of 7% is defined as the yield for one-year Malaysian government treasury plus assumed equity risk premium.

ESG Scoring & Guideline

	Environmental	Social	Governance	Average
Scoring	★★★	★★★	★★★★	★★★
Remark	Although dairy farming is one of the key contributor to global greenhouse gas emission, emission from Farm Fresh's Malaysian and Australia farm are reported to be 27% and 47% lower than average Asian and Oceania peers.	Farming and trading of dairy-related products helps to meet nutritional needs of consumers. Besides, the group provide employment opportunities to rural and indigenous demographic and encourage micro-entrepreneurship.	The board is well represented by independent directors and has decent diversity. Farm Fresh has targeted dividend payout of 25%.	

- ★★★★★ (≥80%) : Displayed market leading capabilities in integrating ESG factors in all aspects of operations, management and future directions.
★★★★★ (60-79%) : Above adequate integration of ESG factors into most aspects of operations, management and future directions.
★★★★ (40-59%) : Adequate integration of ESG factors into operations, management and future directions.
★★★ (20-39%) : Have some integration of ESG factors in operations and management but are insufficient.
★★ (<20%) : Minimal or no integration of ESG factors in operations and management.

Disclaimer

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As of Monday, March 07, 2022, the analyst, Jeff Lye Zhen Xiong, who prepared this report, has interest in the following securities covered in this report:
(a) nil

Kaladher Govindan – Head of Research

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