BCT Asia advisory | BURSA MidS

INITIATION REPORT ***20 October 2017***

Name of PLC: *Can-One Berhad (Can-One)*		***PLC Website:*** *www.canone.com.my*	
Business Summary : *Manufacture and distribution of tin cans, plastic jerry cans and food products*			
Top Three Shareholders: *Yeoh Jin Hoe* *Teh Khoy Gen* *Koon Yew Yin*			*27.0%* *19.9%* *5.0%*
Market / Sector:	*Industrial Products*	***Stock Code:*** ***Bloomberg Ticker:***	*5105* *CAN:MK*
Market Capitalisation:	*RM 549.6m*	***Recommendation:***	*BUY*
Target Price:	*RM 4.00*	***Expected Capital Gain:*** ***Expected Div Yield:*** ***Expected Total Return:***	*40%* *1%* *41%*
Current Price:	*RM 2.86*		
Analyst : Lim Boon Ngee *| Tel : +603 2163 3200; Email : bnlim@bcta.com.my*			

Key Stock Statistics	**2015**	**2016**	**2017F**	**2018F**
EPS (sen)	40.2	45.0	37.1	45.3
P/E (x)	7.1	6.4	7.7	6.3
Net Dividend/Share (sen)	4.0	4.0	4.0	4.0
NTA/Share (RM)	3.43	3.89	4.22	4.63
Book Value/Share (RM)	3.44	3.90	4.23	4.64
Issued Capital (mil shares)	192.2	192.2	192.2	192.2
52-weeks Share Price Range (RM)				2.84 - 3.77
Estimated free float				28.2%
Average volume (shares)				1,190,000

Per Share Data	**2015**	**2016**	**2017F**	**2018F**
Year-end 31 Dec				
Book Value/Share (RM)	3.44	3.90	4.23	4.64
Operating CF/Share (sen)	13.9	69.7	26.5	21.4
EPS (sen)	40.2	45.0	37.1	45.3
Net Dividend/Share (sen)	4.0	4.0	4.0	4.0
P/E (x)	7.1	6.4	7.7	6.3
P/Cash Flow (x)	20.6	4.1	10.8	13.3
P/Book Value (x)	0.8	0.7	0.7	0.6
Dividend Yield (%)	1.4	1.4	1.4	1.4
Payout Ratio (%)	9.9	8.9	10.8	8.8
ROE (%)	13.1	12.3	9.1	10.2
Net Gearing (%)	73.1	52.5	48.0	45.6

P&L Analysis (RM mil)	**2015**	**2016**	**2017F**	**2018F**
Revenue	886.47	928.18	1,070.10	1,186.13
EBITDA	94.45	108.25	96.72	113.86
Depreciation & amort	(20.38)	(22.79)	(22.59)	(23.71)
Net interest income	(20.33)	(20.09)	(18.59)	(18.66)
Associate	41.79	41.62	32.41	35.86
Pre-tax Profit	95.53	106.99	87.95	107.36
Net Profit	77.33	86.37	71.24	86.96
EBITDA Margin (%)	10.7	11.7	9.0	9.6
Pre-tax Margin (%)	10.8	11.5	8.2	9.1
Net-Margin (%)	8.7	9.3	6.7	7.3

1. Investment Highlights/Summary

- Can-One is one of the largest tin can and plastic jerry can manufacturer in Malaysia. Through F&BN, it is an established OEM of sweetened condensed milk for local and international brands.

- We like Can-One for its strong positioning in the food industry especially its dominant market share in edible oil segment for the supply of tin cans, and the differentiated OEM model and the attractive growth potentials in the food product division.

- The long-term growth prospects are well anchored by increasing milk consumption in Malaysia, introduction of new product variants, strong potential in export markets leveraging on Halal certification and its planned capacity expansion of Can-One as well as contribution from associate company, KJCF.

- Near term however, profit performance in FY17 will be adversely affected by rising cost of raw materials. With the international sugar price currently having retraced to US 14 cts/lb, the impact of high cost of raw materials should ease going into FY18.

- The stock is currently trading at P/BV of 0.7x based on its book value of RM4.02 as at 2QFY17. We believe the earnings decline in FY17 is already factored into its sluggish share price performance. We initiate coverage on Can-One with a Buy recommendation and a target price of RM4.00 based on its book value.

2. Company Background/Overview

a) History

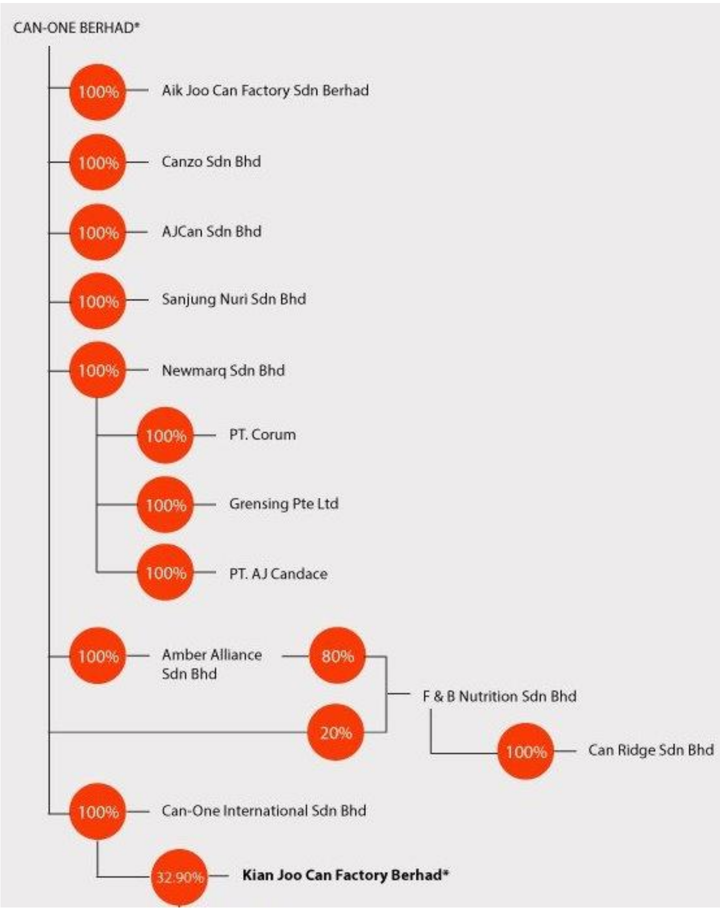
The history of Can-One Bhd (Can-One) can be traced back to 1957 with the setting-up of Aik Joo Can Factory Sdn Bhd as a converter and manufacturer of tin cans. It established its first factory in Mak Mandin, Butterworth in 1968. Backed by consistent demand growth for edible oil tins, biscuit tins and general tin cans in the 1990s, it now has factories strategically located in the northern, central and southern regions of Peninsular Malaysia. In the late-1990s, it had also successfully exported its edible oil tin cans, mainly to the ASEAN markets. It ventured into the manufacturing of plastic jerry cans to complement its edible oil packaging customers through the incorporation of Canzo Sdn Bhd (Canzo) in Oct-03.

Can-One was incorporated as a means to consolidate all the operating subsidiaries, and subsequently was listed on the Bursa Malaysia Securities Berhad (previously known as Kuala Lumpur Stock Exchange) on 19-Jul-05.

F & B Nutrition Sdn Bhd (F&BN) was acquired in 2006 to venture into the original equipment manufacturer (OEM) of sweetened condensed creamer. PT Corum was established in 2011 to manufacture plastic jerry cans and metal tin cans in Indonesia.

Today, Can-One is one of the largest tin can and plastic jerry can manufacturer in Malaysia and is a market leader in the edible oil segment. Through F&BN, it is an established OEM of sweetened condensed creamer and evaporated creamer for local and international brands.

b) Corporate structure



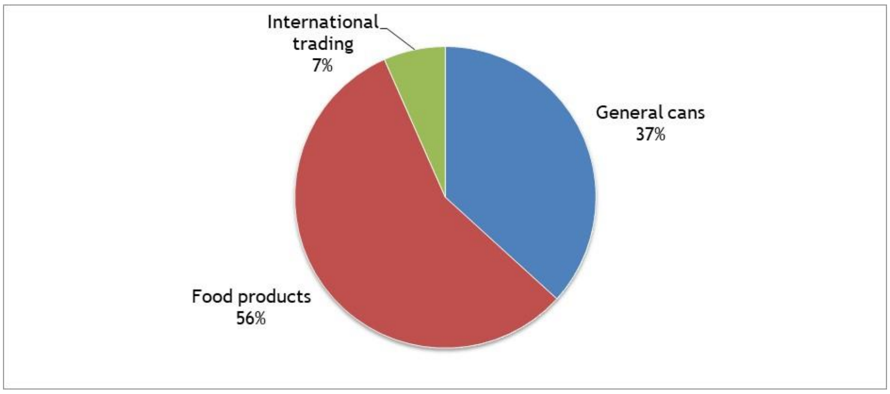
Source: Company's website
** Listed on the Main Market of Bursa Malaysia Securities Berhad*

3. Business Operations

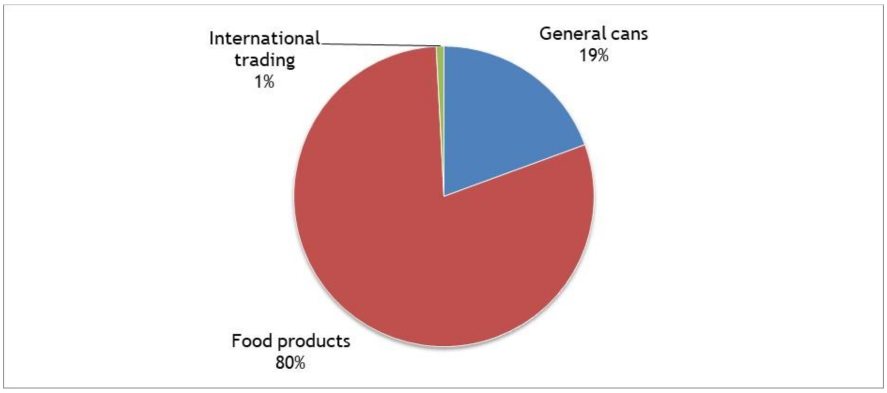
The scope of business activities is illustrated in the diagram as follow:-

i. General cans division - manufacture of metal and lithographed tin cans, plastic jerry cans and rigid packaging;
ii. Food products division - manufacturing, packaging and distribution of dairy and non-dairy products
iii. International trading – trading of raw materials and dairy products; and
iv. Property and investment holding - investment in property, quoted and unquoted shares of company

Turnover breakdown by segmental (FY16) (before inter-segment elimination)



Segment PBT breakdown by segmental (FY16)



a) General cans division

This division is principally involved in the manufacture of metal and lithographed 3-piece tin cans, plastic jerry cans and plastic rigid bottles (rigid packaging). Tin cans manufactured by the Group are supplied to a wide variety of industries including edible oil, confectionary, biscuits, dry food (milk powder and others), condensed milk, paints and chemical. Jerry cans are suitable for packaging, storing and transporting liquid substances commonly used by edible oil and pharmaceutical companies. Canzo manufactures bottles and jars made from PET, HDPE and PP for F&B, nutritional and various other industries. By product categories, tin cans are the largest contributor, contributing 65% to the turnover of the general cans division in FY16. Plastic jerry cans and plastic rigid bottles each accounted for 25% and 10% of the turnover of general cans division respectively. Its products are sold locally as well as to various regions of the world, including South-East Asia, South Asia and Oceania. This division accounted for 37% and 19% of group turnover and segment PBT in FY16.

In Malaysia, its factories are strategically located with close proximity to its customers. It currently operates from three locations in Butterworth (Penang), Telok Panglima Garang, Kuala Langat (Selangor) and Pasir Gudang (Johor). Its wholly-owned PT Corum manufactures jerry cans in Indonesia.

The Malaysian Tin Cans Manufacturer Association which is the trade association representing this industry has twenty members. In Malaysia, Kian Joo Can Factory Berhad (KJCF) has a market share of about 35-40% of the tin cans market, while Can-One Bhd is the close second with a market share of around 30-35%. Can-One's niche lies in the supply of tin and jerry cans to the edible oil industry, accounting for around 60-65% of general cans revenue. Can-One is the largest domestic player for 17-kg tin cans and jerry cans in the edible oil sector, with a share of market of around 70%.

b) Food products division

In 2006, Can-One diversified into the manufacture, packaging and distribution of dairy and non-dairy products on an OEM basis through the acquisition of F&BN. Operating out of Telok Panglima Garang, Kuala Langat (Selangor), it currently produces sweetened condensed creamer, evaporated creamer and sterilised flavoured milk for various brands of dairy products. Its customers consist of both domestic and overseas companies. This division accounted for 56% and 80% of group turnover and segment PBT in FY16. In FY16, about 2/3 of its turnover was derived from export markets particularly from the Middle East, African Continent, ASEAN countries and South Asia.

c) International trading

This division is principally involved in the trading of dairy products and raw materials of the group. This is the smallest division. In FY16, it reported a segment PBT of RM0.65m on a turnover of RM45.23m.

d) Associate

Can-One via its wholly-owned subsidiary, Can-One International Sdn. Bhd., completed the acquisition of 32.90% stake in Kian Joo Can Factory Berhad (KJCF) from Kian Joo Holdings Sdn. Bhd. - In Liquidation on 25-Jan-12 for RM241.12m cash (RM1.65/share).

KJCF, the largest packaging company in the ASEAN region, produces all types of tin cans, aluminium beverage cans and containers, corrugated carton boxes, and other plastic products for the local and export markets. KJCF contributed RM41.62m in net profit to Can-One's group net profit of RM86.37m in FY16.

4. Financial Review

a) Revenue Breakdown by Segmental (RMm)

RMm	FY11	FY12	FY13	FY14	FY15	FY16	5Y CAGR
General cans	342.47	361.13	360.44	405.55	404.23	400.87	3.2%
Food products	368.85	518.19	484.45	585.17	564.97	617.50	10.9%
International trading	-	115.26	81.24	110.58	128.15	72.39	
Property & investment	6.06	34.33	28.77	-	-	-	
Eliminations	(86.40)	(239.09)	(182.02)	(202.36)	(210.87)	(162.57)	
Total Turnover	**630.98**	**789.82**	**772.88**	**898.95**	**886.47**	**928.18**	**8.0%**
% growth							
General cans	21.7%	5.4%	-0.2%	12.5%	-0.3%	-0.8%	
Food products	67.6%	40.5%	-6.5%	20.8%	-3.5%	9.3%	
Total Turnover	**40.5%**	**25.2%**	**-2.1%**	**16.3%**	**-1.4%**	**4.7%**	

b) **Turnover breakdown by geographical**

RMm	FY11	FY12	FY13	FY14	FY15	FY16	5Y CAGR
Malaysia	506.70	550.47	614.19	665.87	654.36	699.57	6.7%
Asia	123.75	228.94	149.07	210.95	198.95	192.45	9.2%
Others	0.54	10.40	9.62	22.14	33.17	36.16	132.0%
Total Turnover	**630.98**	**789.82**	**772.88**	**898.95**	**886.47**	**928.18**	**8.0%**

- The food products division continued to be the main catalyst for growth, underpinned by strong demand for its products from existing and new customers following its expansion drive. The growth in the food products division also created increased internal demand for the general cans division.

- Its turnover growth had been sustained, supported by additional processing plants, additional capacity and increase in its product range.

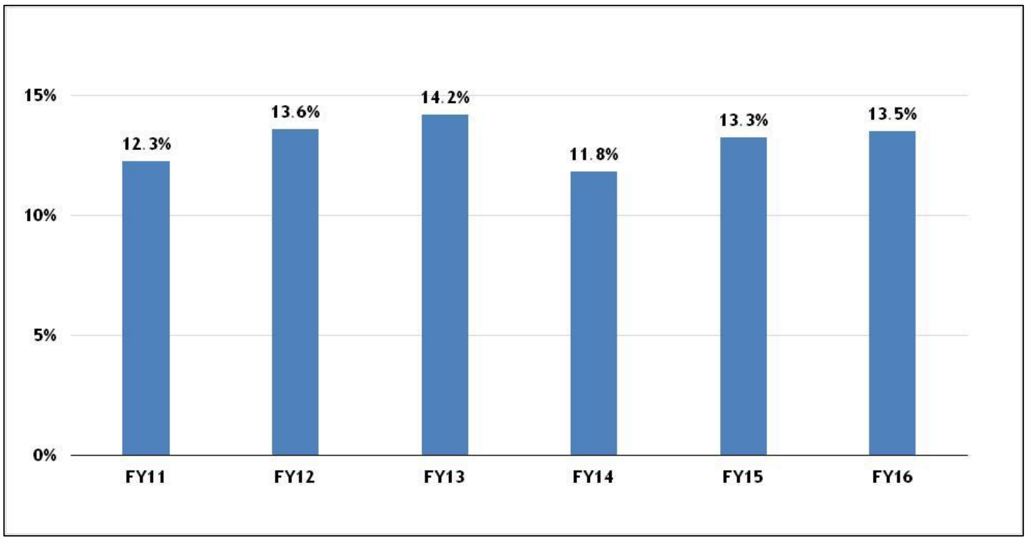
    - Third processing plant for the production of sweetened creamer in late-FY11 with doubling of production capacity;
    - New evaporated creamer plant in Jun-15;
    - First commercial run of sterilised milk in Jan-14; and
    - Commissioning of flexible packaging of sweetened condensed milk in Jul-16

- The food products division had been generating stronger growth due to its export potential and marketing efforts to capture a larger share in the ASEAN and Africa markets. In 2HFY15, it added additional capacity for a new evaporated milk plant, which led to a stronger turnover growth in FY16.

c) PBT Breakdown by Segmental (RMm)

RMm	**FY11**	**FY12**	**FY13**	**FY14**	**FY15**	**FY16**
General cans	34.96	32.93	27.34	16.79	10.09	15.52
Food products	16.40	49.08	51.98	47.23	57.08	63.77
International trading	-	3.47	1.34	2.20	3.14	0.65
Property & investment	(0.63)	(2.97)	(5.31)	12.42	16.72	65.85
Adj & elimination	(8.82)	(22.61)	(20.40)	(26.45)	(33.28)	(80.42)
Associates	-	31.23	39.02	35.89	41.79	41.62
EI	-	103.75	-	-	-	-
Total PBT	**41.91**	**194.88**	**93.96**	**88.09**	**95.53**	**106.99**
PBT margin						
General cans	10.2%	9.1%	7.6%	4.1%	2.5%	3.9%
Food products	4.4%	9.5%	10.7%	8.1%	10.1%	10.3%
International trading	-	3.0%	1.6%	2.0%	2.4%	0.9%
Total PBT	**6.6%**	**24.7%**	**12.2%**	**9.8%**	**10.8%**	**11.5%**

d) Historical Gross Margin Trend



- The food product division accounted for 80% of group PBT in FY16. The OEM in the production of sweetened condensed creamer and evaporated creamer enjoyed a more superior and steadier PBT and PBT margin performance as compared with general cans division.

- Given the division's more significant profit contribution to the group, overall group gross profit margin has also remained quite steady. At the group level, Can-One's historical gross profit margin ranged between 12-14%.

- Since FY12, Can-One's group PBT was boosted by additional associate profit contribution from KJCF. The acquisition of a 32.9% stake in KJCF was completed on 25-Jan-12. In FY12, Can-One recognized an one-off gain of RM103.75m being the difference between the book value of KJCF and the purchase consideration.

- The profitability of general cans division is susceptible to the fluctuations in raw material prices such as tin plates and resin prices. In FY14-15, it suffered from margin erosion in the plastic packaging section due to stiff market competition and lack of economies of scale. However, as profit contribution from food products division remained more dominant, the impact from fluctuation in commodity prices was not so apparent at the group level.

- In Jun-15, Can-One completed the acquisition of the remaining 20% stake in F&BN from Mr Teh Khoy Gen for RM112.9m via the issuance of 39.75m new shares at RM2.84/share. Consequently, F&BN became a wholly-owned subsidiary of Can-One.

5. Competitive Analysis

- The production of dairy creamers commands a relatively **higher barrier to entry** due to the high capital investment needed for setting up of manufacturing facilities and compliance with stringent food and safety standards, R&D capabilities, Halal certifications and products' certification/approval in various exporting countries.

- **Strong positioning in food industry,** whereby 56% of group turnover is derived from F&BN. Within the general cans division, around 2/3 of segment revenue is contributed by the edible oil and sweetened condensed milk segments, which typically is more resilient in demand consumption. Can-One is also the leading producer of tin cans and jerry cans used in the edible oils sector.

- **Trusted OEM manufacturer** for both local and international brand owners that is backed by efficient sourcing of quality raw materials, competitive pricing, in-house R&D and own formulation.

6. Earnings Outlook

- Demand growth is largely driven by sustained consumption, export growth and growth in palm oil production and exports. The consumption demand is resilient and recession-proof as its products can be regarded as a daily necessity.

Turnover Breakdown by Segmental (1H FY17) (RMm)

RMm	FY16	1H FY16	1H FY17	Chg
General cans	400.87	184.52	242.43	31.4%
Food products	617.50	303.45	343.99	13.4%
International trading	72.39	30.07	52.12	73.3%
Property, investment & elimination	(162.57)	(71.11)	(101.23)	42.4%
Total Turnover	**928.18**	**446.94**	**537.31**	**20.2%**

PBT Breakdown by Segmental (1H FY17) (RMm)

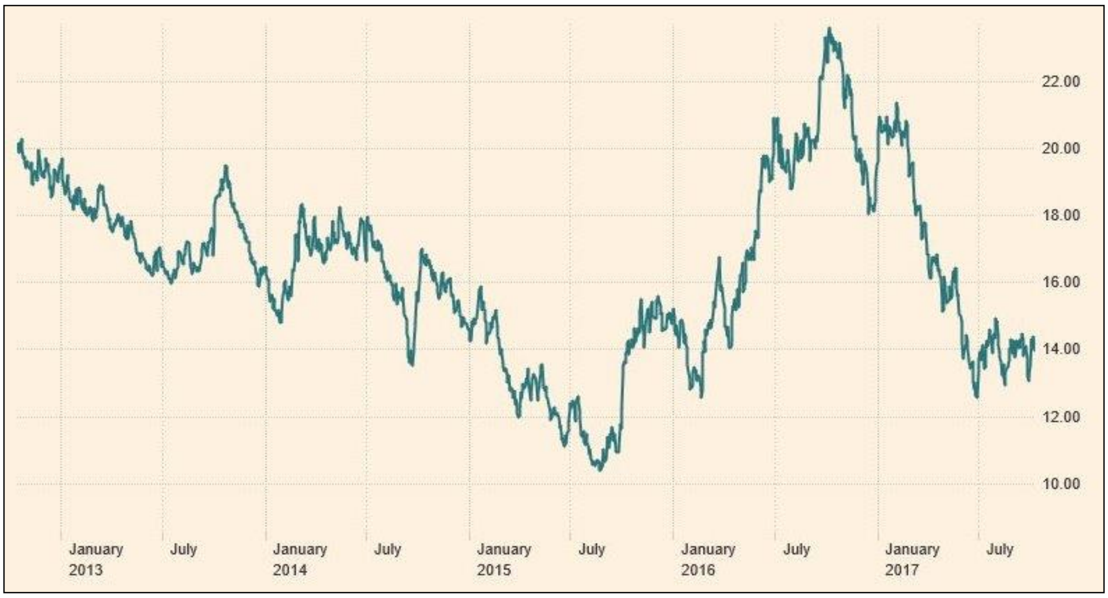
RMm	FY16	1H FY16	1H FY17	Chg
General cans	15.52	4.48	12.85	186.8%
Food products	63.77	35.51	22.66	-36.2%
International trading	0.65	0.18	0.97	426.6%
Property, investment & elimination	(14.58)	(8.20)	(8.24)	0.5%
Associates	41.62	16.50	10.69	-35.2%
Total PBT	**106.99**	**48.48**	**38.93**	**-19.7%**
PBT margin				
General cans	3.9%	2.4%	5.3%	
Food products	10.3%	11.7%	6.6%	
International trading	0.9%	0.6%	1.9%	
Total PBT	**11.5%**	**10.8%**	**7.2%**	

- For its **general cans division**, segment PBT turned around with a 154% jump to RM15.52m in FY16 due to favourable raw material prices and stronger US$ despite the flattish turnover performance. In 1HFY17, PBT nearly tripled to RM12.85m from RM4.48m (1HFY16) due to strong volume growth, improved profitability of jerry cans and rigid packaging divisions as well as discontinuation of loss-making flexipackaging division. Going forward, the profit growth trend can be sustainable driven by volume growth and improved profitability of the plastic packaging division.

- For its **food products division**, while turnover still grew by 13.4% in 1HFY17, PBT declined by 36.2% to RM22.66m from RM35.51m (1HFY16) due to higher raw material prices, especially sugar as well as the strengthening of the Malaysian ringgit, which led to lower profitability.

  The overall profit performance in FY17 will still be adversely affected by the still high local pricing of sugar. With the international sugar price currently having retraced to US 14 cts/lb from above US 20 cts/lb, the impact of high costs of raw materials should ease going into FY18.

Sugar price (US cts/lb)



- Longer-term, Can-One will be embarking on an **expansion plan** over FY17-19 to set up a new production plant for both food products and general cans division. In Mar-17, F&BN has acquired a piece of freehold industrial land together with factory (located next to its existing factory) for RM30m cash.

The total investment required would amount to around RM80-100m to be spent over FY17-19. Construction is expected to start towards end-FY17 with commercial run targeting towards end-FY18 or early-FY19.

- The long-term demand drivers are well underpinned by increasing milk consumption in Malaysia, introduction of new product variants, strong potentials in export markets leveraging on Halal certification

- Its 32.9%-owned associate, **KJCF** also has plans for big expansion programmes by venturing into Myanmar for the setting-up of metal cans packaging and corrugated cartons plants. It recently just added two new production lines for the aluminium cans division in FY16.

  Similarly for KJCF, while the long-term growth prospects are promising, its short-term profit performance will be adversely affected by rising cost of raw materials, weak pricing power amidst the current weak consumer sentiment, higher depreciation costs and finance charges associated with capacity and Myanmar expansion. We expect these initiatives to only deliver meaningful positive impact from FY19 onwards.

7. Balance Sheet

RMm	**FY12**	**FY13**	**FY14**	**FY15**	**FY16**
PPE	281.42	287.15	301.46	366.18	367.04
Associate	360.74	381.47	411.16	461.14	502.35
Other LT assets	1.71	1.41	1.41	1.76	1.95
Current Asset	347.20	382.19	519.26	507.61	517.55
Current Liabilities	243.66	240.72	383.42	389.22	390.09
LT Liabilities	336.13	328.97	299.93	285.91	250.31
Shareholders' Funds	**396.98**	**460.61**	**520.81**	**661.56**	**748.50**
MI	14.31	21.91	29.13	-	-
Total cash and cash equivalent	52.36	38.02	106.15	59.17	82.71
Total borrowings	(454.66)	(430.20)	(526.45)	(542.65)	(475.58)
Net cash	**(402.30)**	**(392.18)**	**(420.30)**	**(483.48)**	**(392.88)**
Net gearing	**101.3%**	**85.1%**	**80.7%**	**73.1%**	**52.5%**
Capex	42.75	27.06	32.41	62.07	19.88
EBITDA	97.57	92.17	87.43	94.45	108.25

- Due to the acquisition of KJCF in FY12, its net debt position expanded to RM402.30m (FY12) from RM215.69m (FY11). Its net gearing ratio also expanded to 1.0x in FY12 from 0.9x in FY11. Subsequently, with strong profit generation and a more modest capex, its net gearing has since reduced to a more comfortable level of 0.5x in FY16.

- Over FY17-19, its major capex will be incurred on the land and factory acquisition (RM30m) and new production plant (RM80-100m).

- As at end-FY16, its book value stood at RM3.90/share.

8. Dividend

	FY12	**FY13**	**FY14**	**FY15**	**FY16**
Net dividend (sen)	4.00	5.00	5.00	4.00	4.00
Net dividend (RMm)	6.10	7.62	7.62	7.69	7.69
Dividend payout (%)	4%	11%	12%	10%	9%

- The Group does not adopt any dividend policy. In FY16, its total dividend of 4.0 sen/share translates into a net yield of 1.4%.

9. Recent Developments

- On 15-Apr-16, KJCF and Aspire Insight Sdn Bhd had mutually agreed to terminate their business sale agreement, which entailed the acquisition of all assets and liabilities of KJCF by Aspire Insight Sdn Bhd for RM1.466bn (RM3.30/share).

- 15-Mar-17, F&BN entered into a sale and purchase agreement to acquire a piece of freehold industrial land, together with a unit of factory for RM30m cash.

10. Key Investment Risks

- Can-One's profitability is impacted by the **fluctuation in commodity prices**. The main raw material used in the production of tin cans and jerry cans are tin plates and high density polyethylene (HDPE) resin. Roughly, tin plate sheets constitute about 70% of total production cost for tin cans, whilst HDPE makes up 70-80% of the production cost for jerry cans. Manufacturers like Can-One are able to pass on any significant increase in the cost of raw materials to the customers albeit with a time lag. Hence, the rising prices could adversely affect its profit margin if input cost increase could not be passed-on. For its food product division, raw materials account for the bulk of total production cost. The main raw materials used are sugar, palm oil and milk powder, which are mostly sourced domestically.

- Can-One is exposed to **supplier risk**, as Perusahaan Sadur Timah Malaysia Berhad is the only supplier of tin plates in Malaysia.

- Can-One's profitability is exposed to **forex risks** as its direct materials such as tin plates, resin and milk solid are directly or indirectly quoted in US$. However, there is some form of natural hedging as export sales account for roughly 25% of its turnover. Some of its raw materials such as tin plates, palm oil, sugar and resin are sourced locally.

- The **weakening of the US$ against ringgit** would have an impact on the profitability of food product division.

11. Valuation and Recommendation

- Since hitting a record high of RM5.17 in Jan-16, Can-One's share price has been on a declining trend. It has stabilised at around RM3.50 since Jun-16 but has recently taken a dip again to around RM2.80. We think that the decline in its share price during 1H of 2016 might be attributed to the aborted acquisition of KJCF's assets at RM3.30/share by Aspire Insight Sdn Bhd in Apr-16. Meanwhile, the recent dip in share price could be due to the disappointing profit performance in 1HFY17.

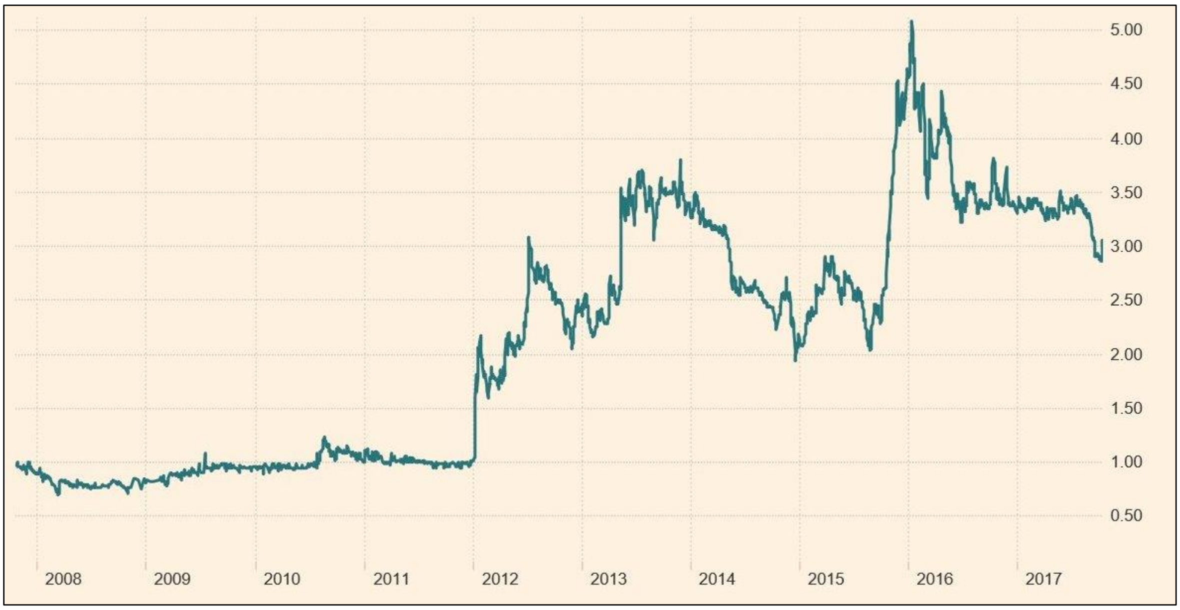
- Nonetheless, we like Can-One for its strong positioning in the food industry especially its dominant market share in the edible oil segment for the supply of tin cans, the differentiated OEM model and the attractive growth potentials in the manufacturing of sweetened condensed milk for both local and exports.

- The long-term growth prospects are well anchored by increasing milk consumption in Malaysia, introduction of new product variants, strong potentials in export markets leveraging on Halal certification and its planned capacity expansion of Can-One as well as contribution from KJCF.

- However, its profit performance in FY17 will still be adversely affected by rising costs of raw materials. With the international sugar price currently having retraced to US 14 cts/lb, the impact of high costs of raw materials should likely ease going into FY18.

- The stock is currently trading at P/BV of 0.7x based on its book value of RM4.02 as at 2QFY17. We believe the earnings decline in FY17 is already factored into its sluggish share price performance. We initiate coverage on Can-One with a Buy recommendation and a target price of RM4.00 based on its book value. Based on our EPS forecast for FY17 and FY18, the stock is currently trading at attractive P/E of 7.7x and 6.3x.

Share price chart of Can-One



Disclosures/Disclaimer

Investment ratings:
Buy (generally >10% upside over the next 12 months)
Hold (generally negative 10% downside to positive 10% upside over the next 12 months)
Sell (generally >10% downside over the next 12 months)

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