



“Sustainable Business Strategy”

We initiate coverage on Dutch Lady Milk Industries Berhad (Dutch Lady) with a **HOLD** call and target price of RM49.72 based on PER multiple of 22x, broadly in line with its last three years PER average, over its FY15 EPS estimate at 226sen. We justify our valuation based on i) its solid fundamentals and strong branding position, ii) aggressive marketing and promotional activities and iii) robust demand of dairy product in the long-term as Malaysia’s population is projected to reach 38 million people by 2040 from 30 million currently. Our target price of RM49.72 offers 6% upside potential in addition to a 4.3% dividend yield in FY15.

Snapshot

Product classification. Dutch Lady’s product can be classified into three different segment comprising of 1) powdered dairy product, 2) liquid dairy product and 3) yoghurt. According to the management, powdered dairy products contribute approximately 65% of the group’s revenue, largely represented by growing up milk and milk for adults. The remaining revenue contributor is derived from liquid dairy product (30%) and yoghurt (5%). The strong consumer demand on growing-up milk powder has contributed to the steady growth in top line as well as bottom line performance where Dutch Lady recorded solid revenue and net profit gained at FY09-FY13 CAGR of 9% and 23% respectively.

Earnings growth. We expect the group to record a net profit growth of 2% y-o-y and 3% y-o-y in FY14 and FY15 respectively lifted by the increase in consumer spending on dairy product in Malaysia in line with our in-house economic growth estimates which suggest that Malaysia’s GDP would continue to grow by 5.5% this year. In tandem with its matured establishment position, we predict Dutch Lady to adopt a dividend

HOLD (TP: RM49.72)

Current Price (RM)	RM46.80
New Target Price (RM)	RM49.72
Previous Target Price (RM)	NA
Previous Recommendation	NA
Upside/(Downside) To Target	6%
Dividend Yield (FY15)	4%

Stock Code

Bloomberg	DLM MK
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Stock Information

Listing	MAIN MARKET
Sector	Consumer
Shariah Compliance	Yes
Issued Shares (mn)	64
Market Cap (RM mn)	2,994
YTD Chg in Share Price	0.3%
Beta (x)	0.58
52-week Hi/Low (RM)	48.45 44.61
3M Average Volume (shrs)	1.75mn
Estimated Free Float	25%

Major Shareholders

Frint Beheer BV	51%
Skim ASB	16%
PNB	2%

payout of between 80%-90% for FY14-FY15, translating into a net yield of 4.3%. Hence, Dutch Lady is essentially a dividend play counter.

Investment Highlights:

1. Milk consumption trend

We expect a healthy long-term outlook for dairy product consumption in Malaysia driven by steady population growth, higher disposable income and increase awareness of nutritional and healthy product among the Malaysian public. According to Malaysia Veterinary Services Department, Malaysia's milk consumption has risen at 26% CAGR over the last three years (2011-2013), translating into milk consumption per capita of 28 litres per person based on total population assumption of 30 million in 2013. The increasing trend in milk consumption in Malaysia will provide ample opportunities for Dutch Lady to grow its domestic business. Added with steady pace of population growth of over 2% per annum, Dutch Lady may experience steady top line growth in the long term.

2. Collaboration with Government on PS1M

Dutch Lady has participated in Program Sekolah Susu 1Malaysia (PS1M) with Ministry of Education in July 2013 to supply fresh milk for primary school children. The government has spent around RM103 million for this project. Dutch Lady provided milk to more than 232,489 selected school children in Kelantan and Terengganu between the age of seven and twelve years in 2013. We believe this program will enhance the branding value of Dutch Lady among children in consuming their dairy nutritious product.

3. Dairy Development Programme

Dutch Lady has developed the Dairy Development Programme (DDP) since 2008 in collaboration with the Department of Veterinary Services (DVS) and the Embassy of the Kingdom of the Netherlands. The main purpose of the programme is to assist local farmers in increasing their milk production with better quality through knowledge transfer session with several Dutch farmers. In addition, there was site visit to FrieslandCampina Vietnam DDP pilot farm in Vietnam to expose local farmers of best practices of farm management. More than 200 farmers has benefited from this program thus ensuring the sustainability of milk supply from local farmers.

4. Benefit from Parent Company

The group also benefit from the support of parent company, Royal FrieslandCampina with 22,000 employees in 100 offices globally across Europe, Asia/Oceania, Africa/Middle East and North/South America. This will enables Dutch Lady to enjoy global procurement services. In addition, its parent's 400 scientists at the Research and Development unit will help in ensuring the quality of Dutch lady's products and practices.

5. Capex plans

The management has allocated around RM18 million of capital expenditure (capex) for FY14 to improve and upgrade the different elements of its product quality and safety. The company also stated that there will be no more capacity expansion for its sole factory in Petaling Jaya for the

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upcoming years. Note that Dutch Lady has allocated between RM15-RM17 million capex in FY13 on expanding the capacity of its ultra-high temperature (UHT) segment.

Company Background

Dutch Lady was incorporated in 1963 and became the first milk company in Malaysia to be listed on Bursa Malaysia in 1968. Dutch Lady is principally engaged in manufacturing and distributing a variety of dairy products and fruit juices for domestic and export market. Dutch Lady's product can be categorized into three different segments consisting of 1) powdered dairy product, 2) liquid dairy product and 3) yoghurt. According to the management, powdered dairy product contributes approximately 65% of the group's revenue that comprise of growing up milk and milk for adults. The remaining revenue contributor is derived from Liquid dairy product (30%) and yoghurt (5%).

UHT milk, sterilised milk and pasteurised milk are among its liquid dairy product. All the products are represented by well-known brands like Dutch Lady, Frisolac, Friso, Completa, Omela and Joy. Dutch Lady gains strong benefit and support from its parent company, Royal FrieslandCampina which befitted as the first company in the world to introduce growing up milk powder in 1988 specifically formulated for children and now being marketed as Dutch Lady 123, Dutch Lady 456 and Dutch Lady 6+.

Product Classification

For the Growing Children					For Mums to Be
DL 123	DL 456	DL 6+	Friso Gold 3	Friso Gold 4	Frisomum Gold
					
For the Family					
DL Chocolate Drink	DL Yoghurt	DL UHT Milk	DL Sterilised Milk, Pasteurised Milk		DL Milk Powder
					

Source: Website

Key management. Dutch Lady is backed by experience board of directors (refer Table 4) with a wide knowledge and exposure in the food and beverage industry. The group is headed by Chairman, Dato' Zainal Abidin Bin Putih and Managing Director, Rahul John Colaco. Dato' Zainal Abidin has a wide experience in local corporate scene as he is currently served as a director of several public listed

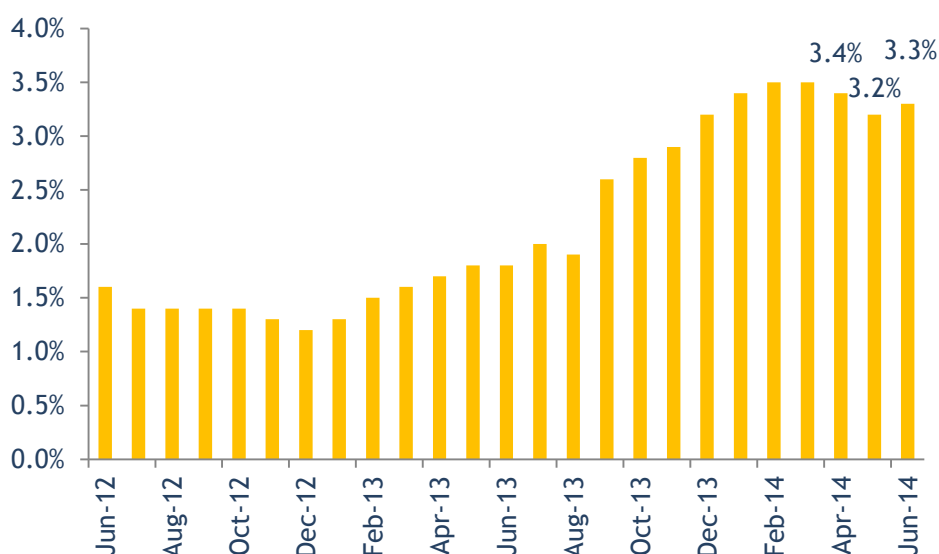
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companies including CIMB Group Holdings Bhd and Tenaga Nasional Bhd. The group's Managing Director, Rahul John Colaco was appointed to the board on 1 April 2012. He started his career in 1997 in a Fast Moving Consumer Goods (FMCG) company in India and held various managerial positions in marketing, sales and purchasing in companies across Asia and Europe.

Industry Overview

Inflation trend. YTD, the Consumer Price Index (CPI) for the period January to June 2014 gained by 3.4% (January-June 2013: +1.6%) due to the increase in all the main groups except for clothing and footwear (-0.1%) and communication (-0.6%). Note that food and non-alcoholic beverages group, the main contributor to CPI, rose by 3.7%. M-o-m, the CPI registered a growth of 3.3% in June 2014 (June 2013: +1.8%). Note that Bank Negara Malaysia (BNM) has adjusted the overnight policy rate (OPR) by 25 basis points at its latest monetary decision meeting in July 2014. One of the reasons for the adjustment in OPR is to combat further rise in inflation given that there are signs that demand pull inflation is creeping in. Nonetheless, our in-house estimates suggest that inflation would continue to be in the level of 3.0% to 4.0% until June or July 2015 due to the implementation of GST.

Malaysia Inflation Trend (June 2012-June 2014)



Source: Statistics Department

Competition. The dairy industry is a fast growing industry with multiple well-known competitors that offer various milk-specialized products. One of the high demands segment is powdered dairy product including growing up milk product. Dutch Lady's brand for children below six years old such as DL 123 and DL 456 is facing a stiff competition mainly from Nestle and Dumex products (Nestle: Lactogen 1-4; Dumex: Dugro 1-6) which adopts a similar marketing strategies and aggressive promotional campaign especially in Hypermarket such as Giant, Tesco and Aeon Big.

Table 1: Selected Brand Competitors

Product Categories	Dutch Lady Brand	Key Competitors
Infant Formula	Dutch Lady, Friso Gold	Lactogen, Nan, Dugro, Mamil
Milk Powder	Dutch Lady	Nespray, Everyday, Fernleaf
Yoghurt	Dutch Lady	Bliss, Marigold

Source: Various sources, M&A Securities

Financial Review (FY09-FY13)

Earnings growth. Dutch Lady's revenue gained at solid FY09-FY13 CAGR of 9% mainly contributed by the strong consumer demand for growing-up milk powder over the period. Note that the group achieved higher revenue growth in FY11 (+16.4% y-o-y) and FY13 (+11.4% y-o-y) respectively lifted by i) effective promotional campaign and strong marketing strategies that pushed sales higher and ii) full year impact of Dutch Lady Chocolate Drink which was introduced in FY12 coupled with the re-launch of Friso range dairy powdered products in 3Q13. The group's PBT and net profit increased at commendable FY09-FY13 CAGR of 23% in tandem with the steady revenue growth and effective cost management despite higher raw material cost.

Dividend policy. Dutch Lady does not have an official dividend policy but the group is fully dedicated to reward its shareholder via dividend payment. Dutch Lady's dividend yield has averaged between 1.9%-5.6% in FY09-FY13 or around 91sen/share-260.0sen/share for the said period. Note that in FY13, the group had paid a dividend of 260.0sen/share or equivalent to 120% dividend payout ratio.

Net Cash. The group has no gearing with net cash position stood at RM188 million as at FY13. We expect Dutch Lady to introduce some new products into the market and may potentially increase its production capacity to raise the product volume as well as adopting a various innovative marketing campaign in line with the group's solid cash position.

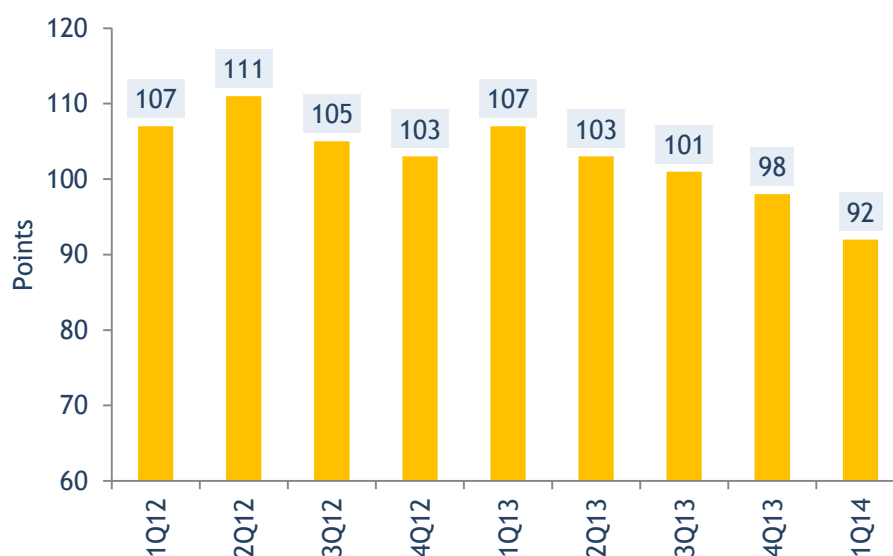
Selected Risks:**1. Less-than-upbeat Malaysian Consumer confidence trend**

According to Nielsen, Malaysia's consumer confidence index stood at 92 points as at 1Q14 (1Q13: 107 points, 4Q13: 98 points), the lowest since the past three years due to the concern of higher cost of living impacted by the rising fuel and grocery prices due to the reduction in government subsidies. Dutch Lady may face intense competition from the other dairy product players such as Nestle and Danone Dumex underpinned by the changes in consumers spending habit.

2. Volatility in raw material price

Dutch Lady may get exposed to the margin pressure due to the hike in raw material prices (e.g. skim milk powder) globally coupled with the weakening of local currency which will drag the company to increase its product prices. Note that Dutch Lady has increased its product price by between 5% and 8% in January 2014 which slightly affected its 1Q14 earnings performance. Nonetheless, we opine that the strengthening in Ringgit against USD currently may offset the volatility in raw material price.

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Malaysian Consumer Confidence Index
(1Q12-1Q14)

Source: Nielsen Consumer Confidence Survey

Earnings Outlook (FY14-FY15)

Earnings assumption. We expect the group to enjoy sustainable earnings growth performance over the next two years or on track to record a net profit growth of 2% y-o-y and 3% y-o-y in FY14 and FY15 respectively lifted by an increase in consumer spending of dairy product in Malaysia in line with our in-house economic growth estimates which suggest that Malaysia's GDP would grow by 5.5% this year. Hence, we expect the group may adopt a dividend payout of approximately between 80% to 90% for FY14-FY15, translating into a commendable net yield of 4.3%.

Valuation and recommendation

We initiate the coverage on Dutch Lady with a **HOLD** call and target price of RM49.72 based on PER multiple of 22x over its FY15 EPS estimate at 226 sen. We justify our valuation based on i) its solid fundamentals and strong branding position which may offset the challenging outlook of consumer behaviour in tandem with the rising cost of living, ii) aggressive marketing and promotional activities via visual and printed media and iii) robust demand of dairy product in the long-term as Malaysia's population is projected to reach 38 million people by 2040 from 30 million currently. Our target price of RM49.72 offers 6% upside potential in addition to a 4.3% projected dividend yield in FY15.

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Table 2: Peers comparison (Calenderised)

Company	YE	Price (RM)	EPS (sen)		P/E (X)		P/BV (X)		ROE (%)	DY (%)	TP (RM)	Call
			FY13	FY14	FY13	FY14	FY13	FY14				
Parkson*	Jun	3.06	17	19	17	16	1	1	5	NA	3.00	Hold
Amway	Dec	12.08	69	73	17	16	9	8	55	3.4	13.00	Hold
Nestle	Dec	68.22	254	277	27	24	18	18	58	3.5	67.24	Hold
MSM	Dec	4.93	34	38	14	13	2	2	13	5.1	5.50	Hold
Dutch Lady	Dec	46.80	216	229	22	20	14	16	58	2.4	49.72	Hold
Padini*	Jun	17.48	15	18	13	11	3	3	24	5.0	2.35	Buy
F&N*	Sept	1.92	69	80	27	23	4	4	18	2.9	NA	NA
Aeon Co	Dec	3.96	18	19	23	21	3	3	14	1.4	NA	NA
QL Resources	Mac	3.45	16	18	19	17	3	3	15	1.0	NA	NA
PPB Group	Dec	14.82	78	85	19	17	1	1	6	1.7	NA	NA
Cocoaland	Dec	1.82	11	13	16	14	1	1	9	3.4	NA	NA
Guan Chong	Dec	1.29	18	19	7	7	2	1	11	NA	NA	NA
Average					18	17	5	5				

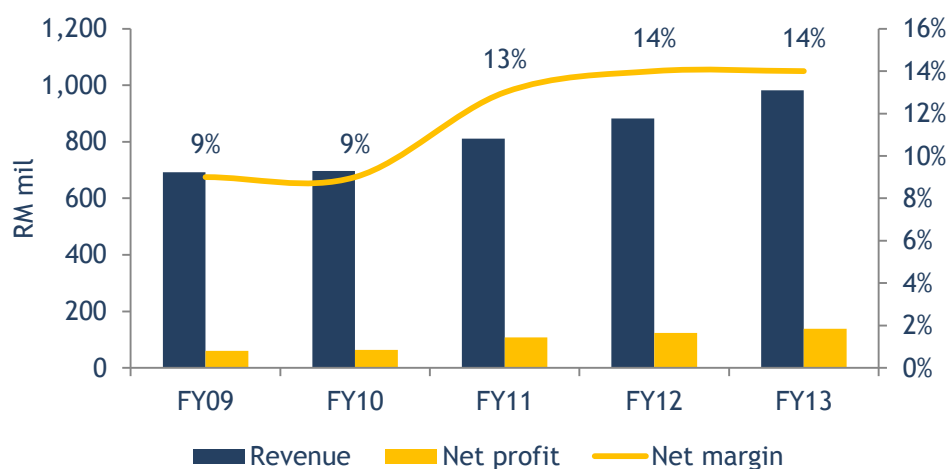
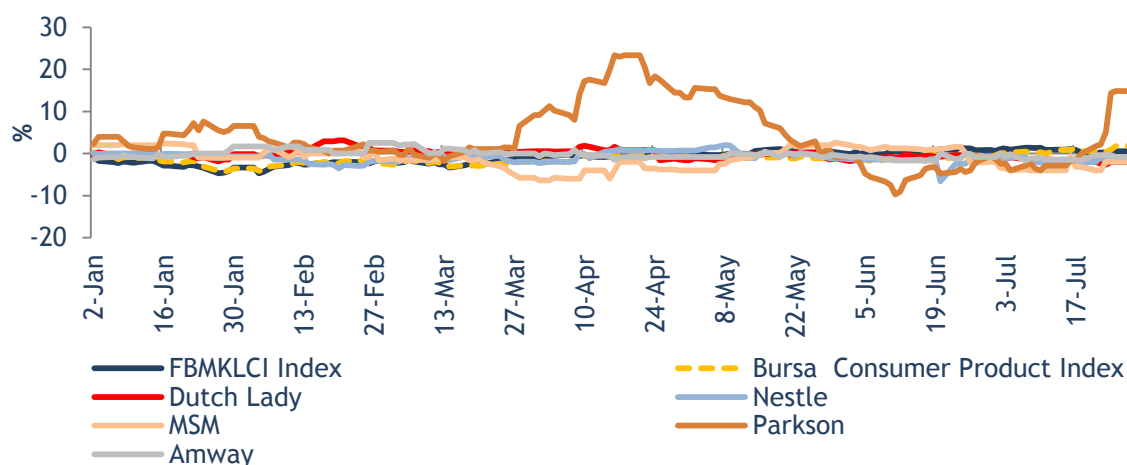
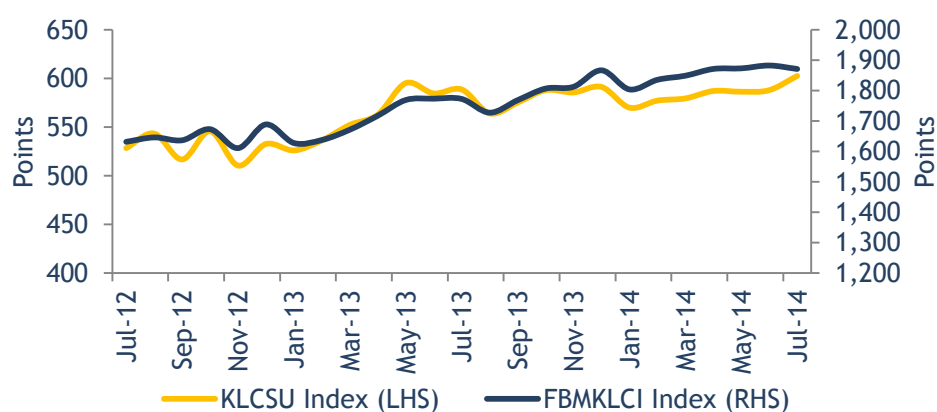
Source: Bloomberg, M&A Securities

Table 3: Financial Forecast

Y/E: Dec (RM'mil)	FY11	FY12	FY13	FY14F	FY15F
Revenue	811	882	983	1,063	1,149
EBIT	139	163	184	187	197
PBT	142	166	187	190	195
Net profit	108	123	138	141	144
EPS (sen)	169	193	216	220	226
EPS growth (%)	69%	14%	12%	2%	3%
DPS (sen)	80	260	260	200	200
Dividend Yield (%)	2%	6%	6%	4%	4%
Dividend payout (%)	47%	135%	120%	91%	89%
PER (x)	28	24	22	21	21
P/BV (x)	12	14	16	15	14
PBT Margin (%)	17%	19%	19%	18%	17%
Net profit margin (%)	13%	14%	14%	13%	13%
ROE (%)	47%	52%	68%	72%	69%
ROA (%)	31%	32%	35%	36%	38%

Source: Company, M&A Securities

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Revenue vs. Net Profit
(FY09-FY13)YTD Performance: Consumer Players vs. FBMKLCI and Consumer Product Index
(January-July 2014)FBMKLCI Index vs. Bursa Malaysia Consumer Product Index
(July 2012-July 2014)

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Table 4: Board of Directors

Name	Designation	Profile
Dato' Zainal Abidin Bin Putih	Chairman	<ul style="list-style-type: none"> Appointed as Chairman since May 2009. A qualified Chartered Accountant (England & Wales). A member of the Malaysian Institute of Certified Public Accountant Director of several public listed companies.
Mr. Rahul John Colaco	ED/Managing Director	<ul style="list-style-type: none"> Appointed as Managing Director since April 2012. Member of Institute of Chartered Accountant of India. MBA from International Institute for Management Development, Lausanne in Switzerland.
Mr. Freek Rijna	NINED	<ul style="list-style-type: none"> Appointed to the Board since January 2013. Member of the Executive Board of Royal FrieslandCampina N.V., with responsibility for business group Consumer Products Asia. Hold degree in Economics and MBA from Erasmus University, Rotterdam.
Mr. Boey Tak Kong	INED	<ul style="list-style-type: none"> Appointed to the Board since November 2001. Director of several public listed companies. Currently serve as Managing Director of Terus Mesra Sdn Bhd. Fellow Member of the Chartered Association of Certified Accountants, U.K. Associate Member of the Institute of Chartered Secretaries and Administrators, U.K. Chartered Accountant of Malaysian Institute of Accountants and Member of Malaysian Institute of Management.
Dato' Dr. Mhd. Nordin Bin Mohd Nor	NINED	<ul style="list-style-type: none"> Appointed to the Board since August 2003. Currently serve as a Director of Sunzen Biotech Berhad. Former Director-General of Department of Veterinary Services, Malaysia. Hold degree in Veterinary Science from the University of Queensland, Australia.
Ms. Saw Chooi Lee	NINED	<ul style="list-style-type: none"> Appointed to the Board since January 2014. Currently serve as a Managing Director of FrieslandCampina Mainland China. Hold degree in Science and MBA from the University of Nebraska-Lincoln, U.S.
Mr. Foo Swee Leng	INED	<ul style="list-style-type: none"> Appointed to the Board since June 1986. Former Managing Director of the company and Regional Director of Friesland Asia Pacific. Hold Degree in Economics from University Malaya.

*ED: Executive Director/ NINED: Non-Independent Non-Executive Director/ INED: Independent Non-Executive Director

Source: Company

M&A Securities

STOCK RECOMMENDATIONS

BUY	Share price is expected to be $\geq +10\%$ over the next 12 months.
TRADING BUY	Share price is expected to be $\geq +10\%$ within 3-months due to positive newsflow.
HOLD	Share price is expected to be between -10% and $+10\%$ over the next 12 months.
SELL	Share price is expected to be $\geq -10\%$ over the next 12 months.

SECTOR RECOMMENDATIONS

OVERWEIGHT	The sector is expected to outperform the FBM KLCI over the next 12 months.
NEUTRAL	The sector is expected to perform in line with the FBM KLCI over the next 12 months.
UNDERWEIGHT	The sector is expected to underperform the FBM KLCI over the next 12 months.

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