FARSONS GROUP
Farsons

Investment Research Report
Full-Year Results as at 31 January 2017

KEY DETAILS

Current Price*[1]:	€7.70	**Latest Financial Reporting Date:**	31 January 2017
2017 High/Low:	€7.73 / €7.00	**No. of Shares in Issue:**	30,000,000
Earnings per Share:	€0.4044 (FY2015/16: €0.3741)	**Price to Earnings Ratio*[1]:**	19.04x
Dividend per share*[2]:	€0.1133 (FY2015/16: €0.1066)	**Net Dividend Yield*[1]:**	1.47%
Major Shareholders*[3]:	Farrugia Investments Limited (26.5%) M.S.M. Investments Limited (26.5%) Sciclunas Estates Limited (26.32%)		
Net Asset Value per share:	€4.109 (FY2015/16: €3.649)	**Price to Net Asset Value*[1]:**	1.87x
Market Capitalisation*[1]:	€231 million	**Next Equity Update:**	November 2017
Rating/Opinion:	**LONG-TERM BUY**		

*[1] *Based on share price as at close of trading on 10 July 2017*
*[2] *Paid out of tax exempt profits*
*[3] *As at 4 May 2017*

INTRODUCTION

This report covers the financial results of Simonds Farsons Cisk plc ("Farsons" or the "Group") for the financial year ended 31 January 2017. During the period under review, Farsons registered yet another record turnover from continuing operations of €88.1 million which is 2.4% higher than the corresponding figure of €86 million achieved in the previous comparable period. Despite the increased business activity, total costs, which mainly consist of cost of sales, selling and distribution expenses as well as administrative expenses, only increased by 1% (or €0.71 million) to €75.3 million (FY2015/16: €74.6 million). Given the much larger increase in revenues, operating profits jumped by 12% to a record €12.9 million (FY2015/16: €11.5 million), which translate into an operating profit margin of 14.6% (FY2015/16: 13.3%). Excluding depreciation and amortisation costs, earnings before interest, tax, depreciation and amortisation ("EBITDA") increased by 10.6% (or €1.98 million) to €20.7 million.

Overall, the Group's net profits from continuing operations rose by 8% to €11.9 million as the growth in operating profits outweighed the incidence of higher net finance costs (+7.5% or €0.1 million) and a lower tax credit (-€0.4 million). The Group's discontinued operations – i.e. the property management arm which will be the subject of a spin-off exercise later on this year following shareholders' approval during the Annual General Meeting ("AGM") held on 27 June 2017 – posted a marginal net profit of €0.27 million compared to €0.24 million during the previous financial year.

The Directors recommended a final dividend (paid out of tax exempt profits) of €0.08 per share, representing a 9.1% increase over the final dividend of €0.0733 per share paid out in respect of the previous financial year. The dividend was paid on 28 June 2017 to all shareholders as at close of trading on 24 May 2017 following shareholders' approval during the AGM held on 27 June 2017. Coupled with the unchanged interim dividend of €0.0333 per share (which was also paid out of tax exempt profits), the total dividend declared in respect of the financial year ended 31 January 2017 amounted to €0.1133 per share, representing a 6.3% increase over the total dividend of €0.1066 per share distributed in the previous comparable period.

Looking ahead, following the inauguration of a new beer packaging facility on 7 September 2016, the Group is now geared to pursue its growth ambitions particularly towards untapped export markets. In addition, works on the extension of existing warehousing facilities are currently underway with new loading/unloading bays planned to be completed by July 2017 as well as a truck park. The Group is also engaged in the construction of a new office complex and a more efficient kegging plant/facility.

BASIS FOR RATING/OPINION

- Established household name reflecting strong brands and distinguished corporate governance;
- Excellent track-record indicating resilience amid different economic cycles and industry changes and challenges;
- Consistent growth in profitability and improvement in margins since full market liberalisation in 2008;
- Positive macro-economic environment challenged by cut-throat competition, fragmented market and ongoing changes in consumer buying behaviour;
- Strong drive towards gains in operational efficiency and cost control whilst maintaining high product quality;

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- Continuous investments in capital infrastructure and human resources as well as strong presence in the market through effective marketing, advertising and distribution strategies are of paramount importance;
- Strong cash-generation capabilities, robust financial metrics and low financial risk profile;
- Spin-off of property management arm represents opportunity for the creation of added shareholder value;
- Innovation and export initiatives among the main aims for long-term growth;
- Undemanding valuation gives rise to potential upside in share price though future growth in profitability is largely dependent on the success of the Group's export strategy.

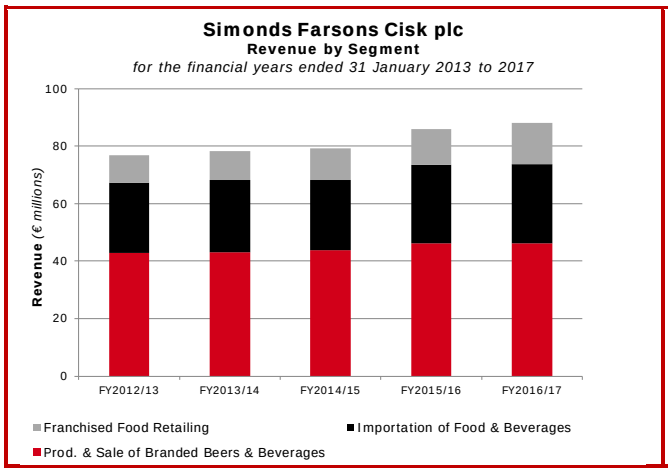
KEY FINANCIAL HIGHLIGHTS FOR FY2016/17

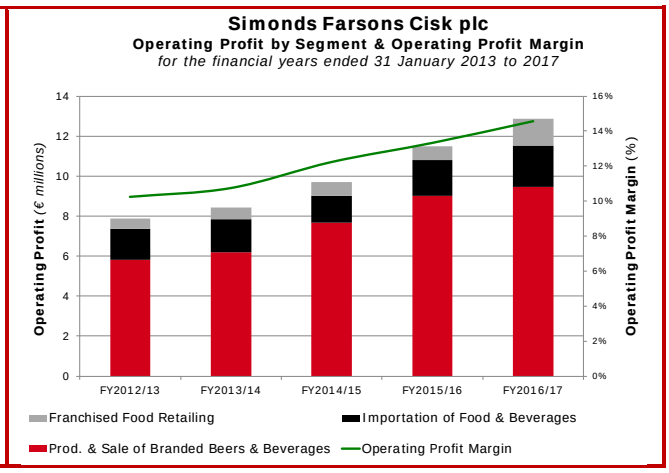
- Revenues from continuing operations grew by 2.4% to €88.1 million;
- Gross profit advanced by 4.4% to €34.4 million – gross profit margin improved by 73 basis points to 39.1%;
- EBITDA climbed by 10.6% to €20.7 million – EBITDA margin improved by 1.74 percentage points to 23.4%;
- Net finance costs increased by 7.5% to €1.47 million as the Group took on additional borrowings to partly fund the new beer packaging facility;
- Interest cover (calculated as EBITDA divided by net finance costs) improved to 14.1 times;
- Pre-tax profits from continuing operations reached an all-time high of €11.4 million (+12.6%);
- Profits after tax from continuing operations improved by 8% to €11.9 million;
- Total assets grew by 12.5% to €182.9 million;
- Total liabilities increased by 12.3% to €59.7 million;
- Shareholders' funds grew by 12.6% to €123.3 million, leading to a net asset value per share of €4.11;
- Gearing ratio (calculated as total debt divided by total debt plus equity) as at 31 January 2017 stood at 22.6%;
- Net debt to EBITDA ratio increased to 1.7 times from 1.3 times in FY2015/16;
- Post-tax returns on average equity and on average assets eased slightly to 10.4% and 7% respectively;
- Total dividends (paid out of tax exempt profits) increased by 6.3% to €0.1133 per share;
- Payout ratio slipped to a multi-year low of 28%.

FINANCIAL & OPERATIONAL OVERVIEW FOR THE FINANCIAL YEAR ENDED 31 JANUARY 2017

Income Statement:

During the financial year ended 31 January 2017, Farsons generated a record of €88.1 million in **revenues from continuing operations**, representing a 2.4% increase from the previous year's figure. This was largely achieved on the back of the improved performance of the '*Franchised food retailing*' segment which registered revenue growth of 16.6% (or €2.06 million) to €14.5 million (FY2015/16: €12.4 million). On the other hand, revenues generated by the '*Importation of food and beverages*' segment increased by a minimal 0.4% (or €0.12 million) to €27.5 million (FY2015/16: €27.4 million) while the '*Production and sale of branded beers and beverages*' segment reported a decline in sales of 0.2% (or €0.09 million) to €46.1 million (FY2015/16: €46.2 million).





As the above charts clearly show (providing the revenue and operating profit by segment as well as the operating profit margin over the last five years), the '*Production and sale of branded beers and beverages*' segment remained the largest and most important contributor to the financial performance of Farsons during FY2016/17 as it represented 52.4% of total revenues and 73.6% of operating profits. In this respect, it is important to highlight two particular trends. On the one hand, despite the Group's increased efforts at broadening its product line, revenues dropped, albeit by a small margin, as a result of heightened competition, higher market awareness on obesity and sugar consumption, as well as the effect of a new excise duty payable on water and soft drinks in a particularly price-sensitive market. On the other hand, however, operating profit generated by the '*Production and sale of branded beers and beverages*' segment increased by 4.9% to €9.46 million reflecting the additional operational efficiencies gained through the

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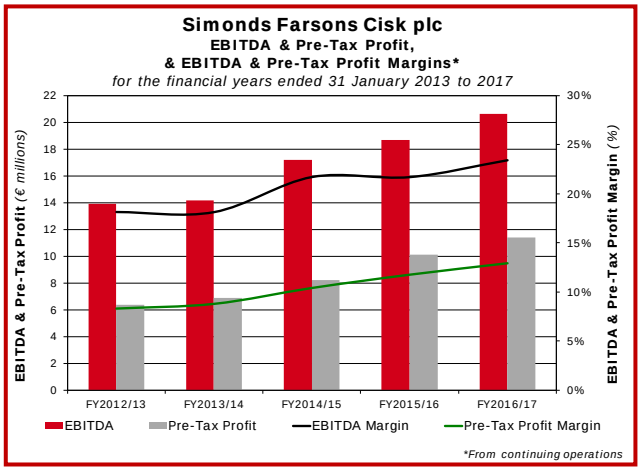
installation of a new beer packaging facility which was inaugurated in September 2016. The latter also offset the related increase in depreciation costs. As a result, the operating profit margin of the '*Production and sale of branded beers and beverages*' segment surpassed the 20% mark for the first time as it climbed to 20.5% from 19.5% in the previous comparable period.

The Group's second largest contributing arm is the '*Importation of food and beverages*' segment. Although it is now the segment which operates at the lowest operating margin, the results achieved by the '*Importation of food and beverages*' segment in FY2016/17 were indeed positive. While revenues increased by only 0.4% to €27.5 million, operating profits jumped by 17% to €2.08 million. The improved performance was driven by the inclusion of higher-value brands to the portfolio as well as the additional operational efficiencies gained within Quintano Foods Limited – the Group's 100%-owned subsidiary responsible for the importation and sale of food products. The latter mainly reflects a reorganisation at management level which also led to improved management of stock items and a more efficient flow of distribution. Moreover, Quintano Foods benefitted from lower product costs as a result of the weakening of the British Pound against the Euro. Similarly, at Farsonsdirect, the Group invested in additional warehousing capacity and a revamped on-line sales portal which contributed towards an improved overall client shopping experience.

The Group's other operating arm – i.e. the '*Franchised food retailing*' segment – posted the most notable improvement in performance in FY2016/17 as revenues grew by 16.6% whilst operating profits nearly doubled to €1.32 million. During the financial year ended 31 January 2017, the Group opened a new Burger King restaurant and the first Drive-Thru KFC restaurant within PAMA Shopping Village, Mosta, both of which boosted sales and profitability. Furthermore, Farsons continued to invest in the remodelling and upgrading of its franchised food retail outlets and launched various fresh marketing initiatives aiming at strengthening its market presence and positioning.



Given the additional focus towards cost containment and enhanced operational efficiencies, **total costs** incurred by the Group in FY2016/17 (i.e. also including those related to discontinued operations amounting to €0.27 million) but excluding depreciation and amortisation charges of €6.74 million, dropped by 0.6% to €68.8 million (FY2015/16: €69.2 million). The increases in employee benefit expenses (+€1.08 million) and raw materials, imported goods and consumables (+€1.03 million) were offset by a decline in other expenses (-€1.89 million) as well as a gain of €0.35 million made on the disposal of property, plant and equipment.

EBITDA surpassed the €20 million level for the first time in the Group's history as it climbed by 10.6% (or €1.98 million) to €20.7 million. Likewise, the **EBITDA margin** reached an all-time high of 23.4% from 21.7% in the previous comparable period. After taking into account depreciation and amortisation charges which, in the period under review, increased by 21% following the inauguration of a new beer packaging facility early in September 2016, **operating profits** surged by 12% also to new high of €12.6 million. This translates into an **operating profit margin** of 14.6%.

In view of the additional bank borrowings (+€8.12 million) taken on by the Group for the construction of the new beer packaging facility, **net finance costs** increased by 7.5% to €1.47 million. Nonetheless, **pre-tax profits from continuing operations** still improved significantly as they advanced by 12.6% to a record of €11.4 million. After taking into consideration a tax credit of €0.47 million, **net profits from continuing operations** grew by 8% to €11.9 million, which translate into an **earnings per share from continuing operations** of €0.3953 (FY2015/16: €0.366 per share). During the period under review, the Group's property management arm that will be the subject of a spin-off exercise later on this year made a net profit of €0.27 million (FY2015/16: €0.24 million). As a result, the Group's **total net profits** for the year amounted to €12.1 million (FY2015/16: €11.2 million) which translate into an **earnings per share** of €0.4044 (FY2015/16: €0.3741).

Statement of Financial Position:

The Group's **asset base** grew by 9.3% (or €20.4 million) to €182.9 million reflecting a higher aggregate value of property, plant and equipment as a result of the new beer packaging facility which was inaugurated in September 2016. Inventories also rose to €14.6 million (+18.1%) but total cash balances as at 31 January 2017 dropped to €0.77 million from €2.45 million in the previous comparable period.

Similarly, the Group's **total liabilities** increased by 12.3% to €59.7 million (31 January 2016: €53.1 million) reflecting the additional borrowings taken on by the Group to finance its capital investment projects. On the other hand, trade and other payables dropped by 6.4% (or €1.36 million) to €19.8 million. Accordingly, **total shareholders' funds** grew by 12.6% to €123.3 million (31 January 2016: €109.5 million) which translate into a **net asset value per share** of €4.109 (31 January 2016: €3.649). As at 31 January 2017, the Group's total debt of €36 million represented 22.6% of its total funding (i.e. total debt plus equity) whilst the ratio of net debt to equity stood at 0.3 times.

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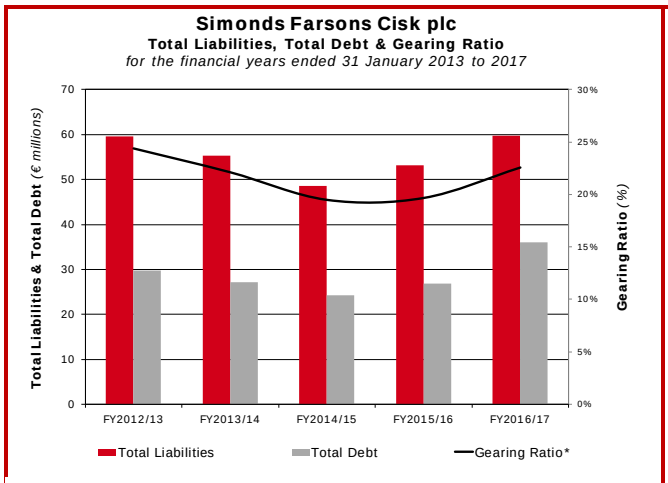
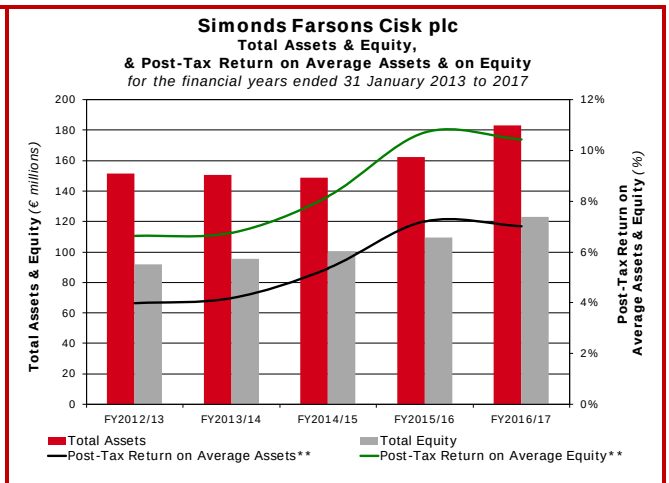


** Calculated as total debt divided by total debt plus equity



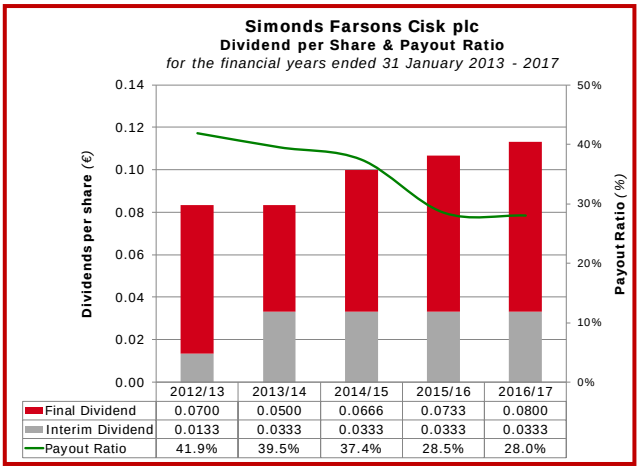
* Includes contribution from discontinued operations

Given the larger percentage increase in shareholders' funds than the corresponding percentage growth in profitability, the Group's **post-tax returns on average equity and on average assets** (calculated as total net profit for the year divided by average shareholders' funds and by average assets respectively) eased to 10.4% and 7% respectively.

DIVIDENDS

The Directors recommended a final dividend of €0.08 per share (paid out of tax exempt profits), representing a 9.1% increase from the final distribution of €0.0733 per share made in respect of the previous financial year ended 31 January 2016. The final dividend was approved by shareholders during the AGM held on 27 June and subsequently paid on 28 June.

Coupled with the unchanged interim dividend of €0.0333 per share paid out of tax exempt profits on 19 October 2016, the total distribution with respect to the 2016/17 financial year amounted to €0.1133 per share compared to €0.1066 in the previous financial year. This represents a net dividend yield of 1.47% based on the current share price of €7.70 as at the close of trading on 10 July 2017.



As the adjacent chart shows (providing the dividend per share and payout ratio of Farsons during the past five years), the growth in profitability registered by Farsons in recent years was not fully reflected in higher dividends paid to shareholders. Indeed, whilst total net profits grew by a compound annual growth rate ("CAGR") of 19.4%, total dividends increased by a CAGR of "only" 8%. As a result, the payout ratio dropped to 28% in FY2016/17 from just under 42% in FY2012/13.

SPIN-OFF OF TRIDENT ESTATES LIMTED

Over the years, Farsons accumulated a significant amount of real estate assets which, on 31 January 2017, had a net book value of €109.1 million (including €4.3 million which were in the course of construction). A total of €31.2 million have been classified as '*investment property held for sale*' following a decision by the Board of Directors to spin-off the property management arm of the Farsons Group – i.e. Trident Estates Limited ("Trident") – into a separate company listed on the Malta Stock Exchange. Following the spin-off, Trident will no longer form part of Farsons and the two entities will pursue their respective strategies independently.

The properties which Farsons has classified as '*held for sale*' consist of properties which: (i) either do not form part of the Group's core operations and which, at present, are either used by the Group's franchised food operations and/or are rented out to third parties; and (ii) existing land and buildings that offer scope for redevelopment as they are currently under-utilised. On the other hand, Farsons will retain ownership of the iconic old brewhouse which will be converted into a distinctive visitors' centre with supporting catering facilities, other retail outlets as well as additional amenities. This development, which is expected to commence later this year at a total cost of €10 million, will also include offices that are earmarked for lease to Trident. Farsons believes that the restoration and re-utilisation of its old brewhouse forms an integral part of its corporate identity and also falls under its responsibility to protect the Group's industrial heritage.

As the table below shows (providing a list of all the properties to be hived-off from Farsons and their respective book value as at 31 January 2017), the two most valuable properties of Trident will be the "Brewery Façade" and "Trident House". The Brewery Façade is the front of the brewery site in Mriehel measuring approximately 16,350 square metres

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("sqm"). It is earmarked for redevelopment into a large office business complex with an accompanying car park and other amenities (the "Trident Park Project"). On the other hand, a detailed study on the potential development of Trident House has yet to be undertaken. This site measures approximately 13,215 sqm of which only 3,210 sqm (or 24.3%) is currently built. Furthermore, only half of the built footprint is currently occupied.

Properties used by franchised food operations / leased to third parties	**Value** *(millions)*
➢ Burger King, Paceville	€3.1
➢ KFC, Gzira	€1.5
➢ Pizza Hut, Sliema	€2.2
➢ Pizza Hut & "Sardinella", St Julian's	€1.7
➢ Pizza Hut, Valletta	€1.3
➢ "Fresco's", Sliema	€0.5
➢ "Scotsman's Pub", St. Julian's	€0.52
➢ Sliema Fort Point Battery (a.k.a. "Il-Fortizza"), Sliema	€1.1
	€11.92
Properties for redevelopment	
➢ Brewery Façade, Mrieħel	€9.05
➢ Trident House, Marsa	€10.2
	€19.25
Total	***€31.17***

Farsons believes that the potential development of both the Brewery Façade and Trident House represent significant opportunities for unlocking shareholders' value which, to date, has largely been kept unexploited. Nonetheless, such major projects require considerable and dedicated financial and management resources which could possibly dent the capital structure, financial soundness and performance of the Farsons Group. Conversely, the separation of the core business of Farsons from any other property-related activities is deemed to be the best way forward in safeguarding shareholders' interests as it would also let Trident pursue its own funding and corporate strategies whilst also focusing on a specialised business activity which requires constant monitoring. Furthermore, the spin-off could also enable the introduction of new investors interested solely in property development within Trident and gives shareholders the possibility to determine whether to remain participants in both businesses or otherwise.

As a result of the spin-off, Trident will be in possession of a mixed portfolio of properties which offer both immediate and on-going rental income as well as potential for long-term capital appreciation. The rental income will be essential for Trident to cover its operating costs and support the servicing of its financing obligations that would need to be raised for the developments of the Brewery Façade and Trident House.

Spin-Off Process & Tax Implications

The spin-off exercise will be executed though a dividend in kind by way of a distribution of one share in Trident Estates plc for every one share held in Simonds Farsons Cisk plc held as at the cut-off date which is still yet to be revealed by Farsons. Accordingly, immediately upon spin-off, eligible shareholders in Farsons will receive the equivalent proportion of shares held in Farsons in the newly listed company.

In addition, the Explanatory Circular for the Annual General Meeting dated 6 June 2017 (the "Circular") confirmed that neither Farsons nor its shareholders as at the cut-off date will incur any tax-related charges solely related to the spin-off exercise.

Financial impact of spin-off on Farsons Group

Assuming no changes to the valuation of each property that will be held by Trident prior to the spin-off taking place, the Circular explains that, on a pro-forma basis, Trident's net asset value following the completion of a restructuring process would amount to €35.6 million (calculated as total assets valued at €37.8 million [mainly composed of investment property valued at €31.2 million plus a cash injection of €6.52 million to be made by Farsons into Trident for the purpose of part-financing the development costs related to the Brewery Façade] less liabilities totalling €2.12 million). Accordingly, the net asset value per share of Trident prior to the execution of the spin-off exercise will be circa **€1.188** (the net asset value of €35.6 million divided by a total of 30 million shares).

The Circular also provides the pro-forma Income Statement and Statement of Financial Position of Farsons as at the end of January 2017 assuming, hypothetically, that the spin-off has already taken place on 1 February 2016 (i.e. on the first day of the past financial year ended 31 January 2017). These show that, from a profitability perspective, there will be a reduction of €0.46 million in net profits at Farsons Group due to: (i) the rental charge that will be paid by Farsons on the properties that will be owned by Trident (€0.7 million); (ii) the loss of rental income due to Farsons from third parties on properties that will be owned by Trident (€0.3 million); (iii) the reduction in ground rent costs that will now be borne by Trident (€0.2 million) as well as Trident's operating expenses (€0.1 million); and (iv) an estimated reduction of €0.2 million in the corporate tax expense of Farsons. Accordingly, the adjusted earnings per share of Farsons drops to **€0.3704** from the actual of €0.4044 as at 31 January 2017. Similarly, from a balance sheet perspective, the total equity of Farsons will decrease by €36.1 million to €87.2 million, leading to a net asset value per share of **€2.906** from an actual of €4.109 as at 31 January 2017.

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As a result of the spin-off, a number of key financial indicators of Farsons will therefore change. These are summarised in the table below which shows that, overall, the profit margins of the Farsons Group will drop minimally due to the projected slight decline in profitability. On the other hand, the returns on equity and on assets will improve to 12.7% and 7.3% respectively from 9.8% and 6.6% on account of a smaller balance sheet size.

Simonds Farsons Cisk plc		Actual FY2016/17	Pro-Forma* FY2016/17
Operating Profit Margin	*(Operating Profit / Revenue)*	14.6%	13.8%
Net Profit Margin	*(Net Profit / Revenue)*	13.8%	12.6%
Interest Cover	*(Operating Profit / Revenue)*	8.8x	8.3x
Post-Tax Return on Assets	*(Net Profit / Total Assets)*	6.6%	7.3%
Post-Tax Return on Equity	*(Net Profit / Total Equity)*	9.8%	12.7%
Net Debt to Equity	*(Net Debt / Total Equity)*	0.29x	0.48x
Gearing Level	*(Total Debt / [Total Debt + Equity])*	22.6%	33.0%

**Assuming a hypothetical scenario in where the spin-off exercise was implemented on 1 February 2016*

The spin-off exercise will also increase the level of indebtedness of Farsons by €6.96 million due to the additional borrowings taken on by the Group to finance the €6.5 million cash injection into Trident prior to the spin-off exercise. These funds are required by Trident in order to part-finance the works related to the Trident Park Project. Nonetheless, the gearing ratio is still expected to remain comparatively low.

Readjustment in the Share Price of Simonds Farsons Cisk plc

The spin-off of Trident from Farsons Group will naturally lead to a readjustment in the share price of Farsons once the latter turns "ex-dividend" – i.e. following the record date (which is yet to be revealed by Farsons) that will determine those shareholders who will be entitled to receive the dividend in kind.

The current market price of Farsons of €7.70 includes the value of the Trident property portfolio. Accordingly, following the implementation of the spin-off, the theoretical share price of Farsons excluding Trident ought to decline by the net asset value of Trident of €1.188 to **€6.512** assuming that the current market share price of Farsons remains unchanged at €7.70. As a result, a number of important metrics would also change as summarised in the table below:

Simonds Farsons Cisk plc		Current Share Price*	Theoretical Share Price following Spin-Off
Share Price		€7.700	€6.512
Net Dividend Yield	*(Dividend paid out of tax exempt profits / Share Price)*	1.47%	1.74%
Earnings Yield	*(Earnings per Share / Share Price)*	5.25%	5.69%
Price to Net Asset Value	*(Share Price / Net Asset Value per Share)*	1.87x	2.24x
Price to Earnings Ratio	*(Share Price / Earnings per Share)*	19.04x	17.58x

** As at 11 July 2017*

SHARE PRICE PERFORMANCE

Simonds Farsons Cisk plc has been one of the best performing equities listed on the Malta Stock Exchange in recent years. In fact, as the data in the table below shows, since 2012 the equity has outperformed the MSE Share Index by a wide margin every year with the exception in 2013 when it underperformed the local equity index by just 0.8 percentage points.

	MSE Share Index	Simonds Farsons Cisk plc	+ / - MSE Share Index
2012	+3.8%	+38.9%	+35.1 p.p.
2013	+14.8%	+14.0%	-0.8 p.p.
2014	-9.6%	+7.1%	+16.7 p.p.
2015	+33.0%	+96.7%	+63.7 p.p.
2016	+4.5%	+16.7%	+12.2 p.p.
2017*	+2.0%	+10.0%	+8.0 p.p.

** As at 11 July 2017*

Furthermore, as the first chart below shows, despite the strong gains registered in the share price between 2012 and 2014, the equity surpassed its net asset value per share only relatively recently in the latter part of February 2015. Thereafter, as the equity continued to perform very strongly and at a faster pace than the growth in net asset value, at the current share price of €7.70 the equity is now almost close to two times its net asset value.

On the other hand, the second chart illustrates the dividend and the earnings yield on the equity of Farsons in comparison with the yield-to-maturity on the ten-year "risk-free" Malta Government Stock ("MGS") benchmark over the past five years. The latter is typically used as the basis over which investors demand an extra premium to compensate for the additional risks involved with holding an equity. In this respect, it is interesting to note that from

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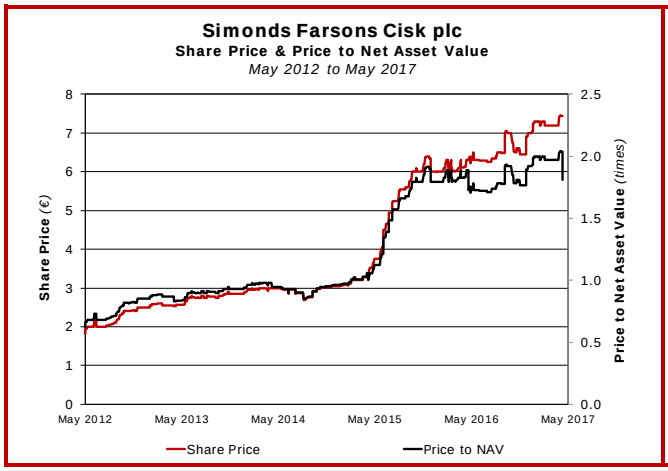
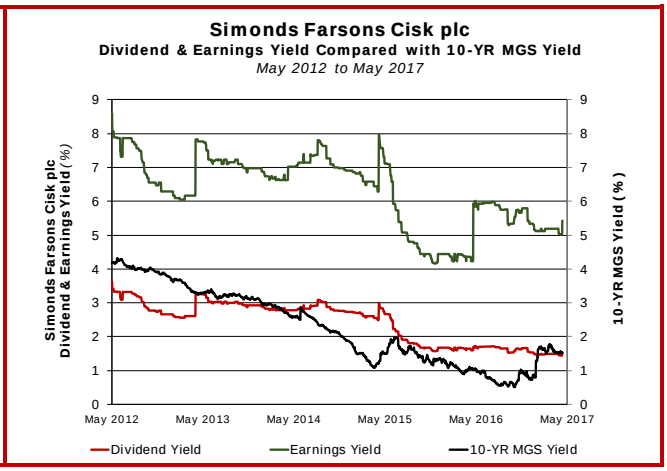
an earnings yield perspective – calculated as earnings per share divided by the share price – the equity of Farsons trended at an average spread of 404 basis points over the ten-year MGS benchmark during this five-year period. In other words, the returns per share which Farsons generated in recent years as a percentage of the share price were consistently well above the returns on the "risk-free" benchmark – meaning that, throughout this period, shareholders of Farsons were being compensated for the added risks involved. Assuming an unchanged earnings per share, a higher share price produces a lower earnings yield thus resulting in a tighter (i.e. less attractive) spread over the 10-year MGS. In the case of Farsons, as the rally in the share price was supported by a surge in the profitability of the Group, the earnings yield remained constantly above the 10-year MGS yield with the spread between the two yields ranging between a low of +237 basis points (20 February 2013) and a high of +676 basis points (29 April 2015) during the five-year period between May 2012 and May 2017.

Conversely, from a dividend yield perspective – i.e. the returns received by shareholders in the form of cash dividends only – the equity of Farsons trended at an average spread of just 15 basis points over the ten-year MGS during the same period, which shows the relative unattractiveness of the dividend yield on the Farsons equity when compared to the "risk-free" benchmark yield. Furthermore, between May 2012 and early April 2014, the yield-to-maturity on the ten-year MGS was higher than the dividend yield on the equity of Farsons. Today, the dividend yield on the equity of Farsons is approximately in line with the yield on the ten-year MGS.





SWOT ANALYSIS

The following SWOT Analysis of Simonds Farsons Cisk plc is based on information made available by the Company as well as further research carried out by us:

Strengths	Weaknesses
➢ Long-established & very well-respected firm ➢ Traditional household name ➢ Strong & conservative corporate governance with adequate succession planning in place ➢ Excellent operating performance in the last five years ➢ Strong portfolio of in-house & other world-renowned beer & beverages ➢ Prudent approach to investment & risk-taking ➢ Robust financial metrics and comparatively low financial risk profile ➢ Efficient state-of the-art facilities	➢ Highly competitive market, including parallel and illicit trading ➢ Price sensitive, value-driven customers ➢ Volume-driven, capital-intensive business ➢ High element of fixed costs ➢ Low barriers to entry in the importation of food & beverages segment ➢ Vulnerable to changes in the prices of raw materials ➢ Dependency on effective marketing, advertising and distribution initiatives

Opportunities	Threats
➢ Increased focus on innovation & export initiatives ➢ Export business represent less than 5% of total revenues generated in FY2016/17 ➢ Adequate capacity to cater for potential further growth in the future ➢ Spin-off of Trident leads to better utilisation of resources ➢ Local consumption of beer per capita significantly lower than other countries ➢ New revenue streams from the redevelopment of the old brewhouse ➢ Potential for achieving further economies of scale	➢ Severe macro-economic downturn ➢ Downturn in tourism numbers ➢ Introduction of further unfavourable changes in tax regime on Farsons' products ➢ Inability to adapt to changing market conditions & consumer trends ➢ Inability to increase penetration in overseas markets

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OUR OPINION

Farsons is a traditional household name in Malta. Over its near ninety years of history, it has constantly proved itself at adapting well to various economic cycles and industry changes and challenges. In particular, since the full market liberalisation in January 2008, the Group reached new highs in terms of profitability as it took advantage of its various and ongoing multi-million capital investments to increase capacity and compete with an expanded and well-diversified product line.

The Group operates in an environment whereby it stands to benefit from a positive and stable macro-economic backdrop but faces challenges in terms of competition and changing trends in consumer buying behaviour. The local economy has been performing exceptionally well in recent years on the back of robust growth rates in tourism numbers and overall consumer spending as well as the continued strong inflow of expatriates many of whom are engaged in high value-added economic sectors like igaming and financial services. In addition, the development of Malta as an all year-round tourist destination, coupled with the more frequent organisation of various types of events involving large gatherings amid favourable weather conditions are additional factors which contribute to steady demand for Farsons' products.

In contrast, a fully-liberated market and the generally stable and positive macro-economic conditions attracted various new food and beverage importers, leading to much higher levels of competition based on product quality, brand and price across all of Farsons' range of offerings. Furthermore, growing consciousness on obesity and sugar consumption are altering consumer buying behaviour obliging Farsons to remain vigilant and pro-active to shifting demands. The Group is also vulnerable to changes in tax and excise duties which also have a negative effect on consumer consumption habits. Accordingly, over the years, Farsons not only had to invest heavily in its capital infrastructure to stay ahead of competition (including that coming from parallel and illicit trading) and reorganise a leaner and more cost-effective management structure, but it was also very important for the Group to keep a strong presence in an already over-populated and highly fragmented market by adopting aggressive marketing, advertising and distribution strategies.

As the table below clearly shows (providing a comparison between some of the key financial indicators of Farsons for the financial year ended 31 January 2009 – i.e. the first twelve-month period following full-market liberalisation in January 2008 – with the corresponding figures for the financial year ended 31 January 2017), Farsons has now become far more profitable and efficient, and its financial position is much stronger today when compared to eight years ago. In fact, during FY2008/09, Farsons posted an EBITDA of €8.2 million and a total net profit of just €0.54 million on revenues of €66.4 million, translating into an EBITDA and a net profit margin of 12.3% and 0.7% respectively. In contrast, in the last financial year ended 31 January 2017, the Group posted an EBITDA of €20.7 million and a net profit of €12.1 million on revenues of €88.1 million, translating into an EBITDA and a net profit margin of 23.4% and 13.8% respectively.

Simonds Farsons Cisk plc		***31 January***	***31 January***
Financial Year ended:		**2009**	**2017**
Earnings per Share *[€]*	*(Total Net Profit for the Year / No. of Shares in Issue)*	€0.0150	€0.4044
Net Asset Value per Share *[€]*	*(Shareholders' Funds / No. of Shares in Issue)*	€2.742	€4.109
Interest Cover *[times]*	*(EBITDA / Net finance costs)*	4.1x	14.1x
EBITDA Margin *[%]*	*(EBITA / Revenue)*	12.3%	23.4%
Net Profit Margin *[%]*	*(Total Net Profit for the Year / Revenue)*	0.7%	13.8%
Post-Tax Return on Average Equity *[%]*	*(Total Net Profit for the Year / Average Shareholders' Funds)*	0.5%	10.4%
Post-Tax Return on Assets *[%]*	*(Total Net Profit for the Year / Average Assets)*	0.3%	7.0%
Net Debt to EBITDA *[times]*	*(Net Debt / EBITDA)*	5.3x	1.7x
Gearing Ratio *[%]*	*(Total Debt / Total Debt and Equity)*	34.8%	22.6%

From a balance sheet perspective, it is worth highlighting that, during the eight-year period between January 2009 and January 2017, the net asset value per share of Farsons climbed by 50% whilst the Group's level of indebtedness, both in absolute terms as well as in proportion to total funding (i.e. equity plus total debt), decreased considerably despite the continuous need for Farsons to undertake significant capital investments. This fact alone also indicates the Group's strong cash-generation capabilities. Furthermore, as the improvements in profitability exceeded the growth in the Group's balance sheet size, the returns which Farsons now makes from its equity and assets increased markedly.

Looking ahead, the spin-off of Trident is another opportunity for Farsons to continue creating additional shareholder value. The Explanatory Circular for Annual General Meeting dated 6 June 2017 shows that, assuming the spin-off of Trident took place on 1 February 2016, the profitability of the Farsons Group for the year ended 31 January 2017 would have only declined by a marginal €0.46 million. On the other hand, as the balance sheet of Farsons will shrink to reflect the net assets of Trident, the returns on equity and on assets which Farsons is expected to make in the future will improve noticeably assuming current levels of profitability are maintained.

The spin-off exercise will also allow Farsons to focus on its long-term growth strategy based on innovation and exports supported by the Group's commitment towards continuous investments in human resources and capital infrastructure. The concepts of innovation and exports are very much interlinked with each other and must also be seen within the context of the newly inaugurated multi-million beer packaging facility as well as other important investments done by Farsons in the past, such as the state-of-the-art brewhouse, soft-drinks packaging hall and logistics centre. Although Farsons claims that consumption of beer in Malta on a per capita basis is well below that in other countries, we believe

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that most of the Group's growth opportunities lie beyond Malta's shores given the notable limitations in the size of the local market. On the other hand, however, the successful penetration into foreign niche markets which the Group has already identified – namely Italy (which is already Farsons' largest export market) and other parts of Europe as well as the United Kingdom, the United States, Asia, the Middle-East, Australia, China and South Korea – is expected to be a gradual, slow-moving, multi-year process given also the changing dynamics and challenges within the industry.[1] Furthermore, Farsons must now also ensure that the added capacity created with the new beer packaging facility is actually put in operation in order not to undergo inefficiencies and under-utilisation of resources.

In Malta, we believe that the potential for further growth in the years ahead may be somewhat limited assuming the current market environment and industry trends remain unchanged although the strong upward trend in tourism very evident this year will again boost the Group's operations during the current financial year to 31 January 2018. Any possible future downturn in the Maltese economy could even give rise to a tougher competitive environment as market participants may resort to stepped-up price-wars to protect market share. In addition, a relatively more hostile operating and competitive environment could also lead to increased parallel and illicit importation.

In spite of the exceptional share price rally of over 30% on a compound annual basis in the last five years to a near all-time high of €7.70 as at 10 July 2017, given the surge in Group profitability the equity of Farsons is still trending at an undemanding price to earnings ratio of 19 times. This should ease to a more attractive 17.6 times on the theoretical share price of €6.512 following the spin-off exercise. Furthermore, the share price is presently trading at an enterprise value (calculated as total market capitalisation plus total net debt) to EBITDA multiple of 12.9 times which is very much in line with the simple average for selected peers in Europe at 12.2 times.[2] Based on the theoretical post-spin-off share price of €6.512, the enterprise value to EBITDA would work out at around 11.5 times, which implies an upside to the share price of above 7% for the equity to equate to the current average for selected peers in Europe.

Overall, we believe that Farsons is now close to start a new chapter in its long-standing corporate history whereby, after the recent completion of major capital investment projects and the upcoming spin-off of Trident, it can look ahead to the future with greater focus towards the potential realisation of further growth and the creation of additional shareholder value. Moreover, the Farsons Group boasts a resilient and robust financial position as well as a comparatively low financial risk profile. On the other hand, however, we also believe that the Group's future growth is largely dependent on the success of its export strategy which, in turn, might take a number of years to gather momentum and make more meaningful contributions to the bottom-line. In view of these factors, we are maintaining our "LONG-TERM BUY" rating on the equity of Simonds Farsons Cisk plc.

From a dividend perspective, Farsons ranks among the lowest-yielding equities listed on the Malta Stock Exchange, mainly reflecting the significant rally in the share price in recent years which by far exceeded the pace of growth in dividends. In our view, following the completion of the major part of the Group's capital expenditure plans as well as the low gearing of the Group, Farsons should now be in a position to increase its payout ratio going forward. Should Farsons maintain a prudent payout ratio, income-oriented investors, whose prime objective is that of generating higher levels of income from their investment portfolio, ought to consider alternative opportunities.

FINANCIALS

The table below provides extracts from the financial statements of Simonds Farsons Cisk plc for the financial years ended 31 January 2013 to 2017 as well as the pro-forma for FY2015/16 assuming that the spin-off of Trident has been hypothetically implemented on 1 February 2016. The latter is based on the data provided in the Explanatory Circular for Annual General Meeting dated 6 June 2017.

Simonds Farsons Cisk plc *for the financial years ended 31 January*	*Actual* *12 months* **2013** ***€000***	*Actual* *12 months* **2014** ***€000***	*Actual* *12 months* **2015** ***€000***	*Actual* *12 months* **2016** ***€000***	*Actual* *12 months* **2017** ***€000***	*Pro-Forma* *12 months* **2017** ***€000***
Income Statement Extracts:						
Revenue	77,180	78,337	79,206	86,033	88,119	88,119
EBITDA	13,926	14,193	17,205	18,680	20,662	n/a
EBIT	7,976	8,417	9,695	11,475	12,852	12,185
Net finance costs	1,495	1,542	1,460	1,363	1,465	1,465
Profit before tax from Continuing Operations	6,418	6,875	8,235	10,112	11,387	10,874
Total Net Profit for the year	5,969	6,325	8,009	11,223	12,132	11,114
Balance Sheet Extracts:						
Total Assets	151,531	150,535	148,758	162,573	182,941	151,679
Total Net Debt	29,703	27,077	24,290	26,833	35,963	42,919
Total Shareholders' Funds	91,925	95,274	100,235	109,459	123,271	87,190

[1] "Around the world, beer consumption is falling - Beer has become less popular in the world's biggest markets", *The Economist*, 13 June 2017 (http://www.economist.com/blogs/graphicdetail/2017/06/daily-chart-8)
[2] Source: Thomson Reuters as at 27 June 2017

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Key Financial Indicators for the financial years ended 31 January		Actual 2013	Actual 2014	Actual 2015	Actual 2016	Actual 2017	Pro-Forma 2017
Total Earnings per Share	(Total Net Profit for the Year / No. of Shares in Issue)	€0.1990	€0.2108	€0.2670	€0.3741	€0.4044	€0.3705
Net Asset Value per Share	(Total Shareholders' Funds / No. of Shares in Issue)	€3.064	€3.176	€3.341	€3.649	€4.109	€2.906
Total Dividend per Share	(Total Dividend Payment / No. of Shares in Issue)	€0.0833	€0.0833	€0.0999	€0.1066	€0.1133	n/a
Dividend Cover	(Total Earnings per Share / Total Dividend per Share)	2.4x	2.5x	2.7x	3.5x	3.6x	n/a
Payout Ratio	(Total Dividend per Share / Total Earnings per Share)	41.9%	39.5%	37.4%	28.5%	28.0%	n/a
EBITDA Margin	(EBITDA / Revenue)	18.0%	18.1%	21.7%	21.7%	23.4%	n/a
Operating Profit Margin	(EBIT / Revenue)	10.3%	10.7%	12.2%	13.3%	14.6%	13.8%
Net Profit Margin	(Net Profit / Revenue)	7.7%	8.1%	10.1%	13.0%	13.8%	12.6%
Post-Tax Return on Average Equity	(Net Profit / Average equity)	6.6%	6.8%	8.2%	10.7%	10.4%	12.7%
Post-Tax Return on Average Assets	(Net Profit / Average assets)	4.0%	4.2%	5.4%	7.2%	7.0%	7.3%
Net Debt to EBITDA	(Net Debt / EBITDA)	**2.1x**	**1.8x**	**1.1x**	**1.3x**	**1.7x**	**n/a**
Gearing Ratio	(Net Debt / Equity)	**0.32x**	**0.27x**	**0.20x**	**0.22x**	**0.29x**	**0.48x**
Gearing Ratio	(Total Debt / Total Debt and Equity)	**24.4%**	**22.1%**	**19.5%**	**19.7%**	**22.6%**	**33.0%**

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Rating Change History:

Company	Rating	Date
Simonds Farsons Cisk plc	LONG-TERM BUY	6 October 2009
	HOLD	14 October 2008
	BUY	28 June 2007
	LONG-TERM BUY	5 June 2006
	BUY	13 October 2005
	UNDER REVIEW	29 April 2005
	BUY	30 June 2004
	HOLD	29 April 2004
	BUY	20 September 2002
	HOLD	26 July 2002

Rating / Opinion Gradings:

Our ratings/opinions are graded as follows: STRONG BUY - total return expected to exceed 25% within the next 2 years; BUY - total return expected to range between 10% and 25% within the next 2 years; LONG-TERM BUY - total return expected to exceed 25% within the next 5 years; HOLD - total return expected to range between +10% and –10% within the next 2 years; SELL - total return expected to drop by 10% or more over the next 2 years; UNDER REVIEW - the previous rating, if any, is no longer in effect and should not be relied upon until a review of the company is completed.

Disclaimer

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