RIZZO FARRUGIA
YOUR INVESTMENT CONSULTANTS

Equity Review
February 22, 2018

Farsons Group
Farsons

INVESTMENT RESEARCH REPORT
Post Spin-Off & FY2017/18 Forecasts

KEY DETAILS

Current Share Price*[1]:	€7.200	**2017/18 High/Low*[1]:**	€9.690 / €7.000
No. of Shares in Issue:	30,000,000	**Market Capitalisation*[1]:**	€216 million
Forecasted Earnings per Share*[2]:	€0.3366	**Forward Price to Earnings per Share*[3]:**	21.4x
Forward EV/EBITDA*[4]:	13.8x	**Forward Price to Net Asset Value*[5]:**	2.3x
Net Dividend per Share: *for the financial year ended 31 January 2017*	€0.1133	**Net Dividend Yield*[1]:**	1.57%
Rating/Opinion:	**HOLD**		

**[1] Based on share price as at close of trading on 20 February 2018.*
**[2] Based on financial forecasts as provided in the Financial Analysis Summary dated 31 July 2017.*
**[3] Calculated as current share price as at close of trading on 20 February 2018 divided by forecasted earnings per share for FY2017/18.*
**[4] Calculated as current market capitalisation plus forecasted net debt as at 31 January 2018, divided by forecasted EBITDA for FY2017/18.*
**[5] Calculated as current share price divided by forecasted net asset value as at 31 January 2018.*

KEY FINANCIAL HIGHLIGHTS FOR H1 2017/18

- During the first six months of the financial year ended 31 January 2018, Simonds Farsons Cisk plc ("Farsons" or "Group") generated €49.2 million in revenues, representing a 7.5% increase over the previous comparable figure as all of Farsons' business segments registered growth on the back of positive macroeconomic factors (namely buoyant tourism figures and strong private consumption) as well as the Group's increased responsiveness towards changes in market trends. In fact, revenues from:
  - the production and sale of branded beers and beverages increased by 7.7% (or €1.89 million) to €26.6 million;
  - the importation of food and beverages registered a growth of 5.8% (or €0.81 million) to €14.9 million; and
  - the franchised food retailing segment expanded by 9.7% (or €0.68 million) to €7.72 million.
- Total overheads grew in line with the overall increase in business. Nonetheless, operating profit still improved by 6% to €6.84 million (H1 2016/17: €6.45 million).
- The operating profit margin eased slightly to 13.9% (H1 2016/17: 14.1%).
- Net profit from continuing operations (i.e. excluding Trident Estates plc) amounted to a record (at interim stage) of €5.72 million (+3.9%), translating into an adjusted earnings per share of €0.1905. However, the net profit margin slipped by 50 basis points to 11.6%.
- The Group paid out an unchanged net interim dividend of €0.0333 per share.
- The net asset value per share as at 31 July 2017 (i.e. including Trident Estates plc) stood at €4.225.

FY2017/18 FORECASTS

- The Prospectus dated 31 July 2017 provided the forecasts for the financial year ended 31 January 2018.
- These show that Farsons is expecting to register a marginally improved performance in FY2017/18 (up to EBITDA level) when compared to the pro-forma financial information for the financial year ended 31 January 2017. The latter statements assume that the spin-off of Trident Estates plc had hypothetically taken place on 1 February 2016.
- In fact, Farsons estimate a 3.4% growth in revenues to yet another record of €91.1 million (pro-forma FY2016/17: €88.1 million) whilst EBITDA is anticipated to reach €19.2 million, representing an increase of 3.3% compared to the pro-forma EBITDA of €18.6 million during FY2016/17. Nonetheless, the EBITDA margin is projected to remain flat at 21.1%.
- On the other hand, operating profit is expected to drop by 3.5% to €11.8 million when compared to the pro-forma figure of €12.2 million, due to higher depreciation charges reflecting the various capital investments amounting to approximately €15.5 million that the Group undertook in recent months.[1]
- Moreover, the forecasted net profit of €10.1 million (which translates into an earnings per share of €0.3366) is expected to be 9.1% lower than the corresponding pro-forma figure of €11.1 million for the previous comparable period, largely reflecting an estimated tax charge of €0.4 million against a pro-forma tax income of €0.24 million in FY2016/17.

- The forecasts also show the expected movements in the Statement of Financial Position of the Group. In this respect, total assets are expected to expand by 7.1% to €162.5 million (pro-forma as at 31 January 2017: €151.7 million).
- Net debt is estimated to climb by 14% to €48.1 million, reflecting additional borrowings taken on by the Group to finance its various capital investments as well as the €6.52 million cash injection into Trident Estates plc that took place prior to the spin-off.
- Shareholders' funds are anticipated to increase by 8% to €94.2 million when compared to the pro-forma figure of €87.2 million as at 31 January 2017. This translates into a forecasted net asset value per share of €3.14.
- Given the larger balance sheet size as well as the reduction in overall profitability, the post-tax return on average equity is anticipated to ease slightly to 11.1% from the pro-forma 11.3% as at 31 January 2017.

[1] These include: additional container un/loading bays; new administrative offices; a new beer and soft drinks kegging plant (including a water bottling line); a truck depot; refurbishment works to chapel and canteen; as well as extension to logistics warehouse.

Rizzo, Farrugia & Co (Stockbrokers) Ltd., Airways House, Fourth Floor, High Street, Sliema SLM 1551, Malta
T. +356 2258 3000 **E.** info@rizzofarrugia.com **W.** www.rizzofarrugia.com

INVESTMENT CONSIDERATIONS

- The financial performance for the six-month period ended 31 July 2017 confirms the Group's strong fundamentals.
- Given the continued positive performance of the local economy throughout 2017 and early 2018, the Group should manage to achieve the various financial targets as set out in the Prospectus dated 31 July 2017.
- Looking ahead, following the completion of the spin-off of Trident Estates plc, the investment rationale towards the equity of Farsons should be based on the food and beverage aspects only.
- In this respect, it is important to highlight that the long-term growth strategy of the Group is mostly based on product innovation and exports supported by continuous investments in human resources and capital infrastructure. As a result, we believe that the most significant growth opportunities for Farsons in the years ahead lie beyond Malta's shores given the notable limitations in the size of the local market as well as the fact that the export business currently represents less than 5% of total revenues.
- Against this background, although the Group has significantly improved its production capabilities in recent years, the further penetration into foreign markets is expected to be a gradual, slow-moving, multi-year process. Whilst Farsons has already identified its main target export markets, namely Italy (which is already the largest export market of Farsons) and other parts of Europe as well as the United Kingdom, the United States, the Middle-East, Australia, China and South Korea, it still needs to establish a more meaningful presence in the aforementioned target export markets in order to register material results.
- Moreover, the success of the Group's export strategy is also influenced by the changing dynamics of the broader brewing industry which, in turn, is largely controlled by a small number of multinationals.

- Overall, we hold a positive view on Farsons reflecting its various unique strengths such as: (i) excellent financial track-record; (ii) strong cash-generation capabilities; (iii) resilient and robust financial position; (iv) conservative corporate governance, including a particularly prudent approach to risk-taking; (v) manufactures own brands ("Cisk" and "Kinnie") and (vi) long-established and reputable brand name.
- Furthermore, given the positive prospects of the local economy (as highlighted by the various recent assessments about Malta both from credit rating agencies and also from some influential supranational organisations such as the European Commission and the IMF), as well as the expected record number of tourist arrivals in 2018 (in its latest forecasts, Malta International Airport plc said that it is expecting to welcome around 6.5 million passengers this year, representing an annual growth in passenger movements of between 7% and 9%), we believe that the EBITDA of Farsons should exceed €20 million during the current financial year ending 31 January 2019 solely from additional business in Malta.
- In addition, our conviction is further supported by the organisation of more frequent social events/celebrations involving large gatherings related with Valletta's status as the European City of Culture 2018 as well as the 2018 FIFA World Cup which should also contribute to further steady demand for Farsons' products.
- In contrast, however, we also take note of the Group's various challenges, including: (i) stiff and fragmented competitive environment; (ii) ongoing changes in consumer buying behaviour; (iii) unfavourable regulatory developments; and (iv) upward pressures on production costs (including tight labour market conditions and volatility in the prices of raw materials).
- **At a price of €7.20, the equity of Simonds Farsons Cisk plc is currently trading at a forward price to earnings multiple of 21.4 times and a forward enterprise value to EBITDA multiple of 13.8 times (based on the 2017/18 forecasts). The latter is higher than the simple average for selected peers across Europe at 12.5 times as at 22 February 2018 (as provided by Thomson Reuters Eikon).**
- **In view of the relatively high valuation, and also taking into consideration the likelihood that it could take a number of years for Farsons to register meaningful growth from its export business, we are downgrading our rating on the equity of Farsons to "HOLD" from "LONG-TERM BUY".**
- **Meanwhile, from a dividend perspective it is important to highlight that Farsons is one of 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, now that the Group has completed the major part of its capital projects, coupled with the low gearing of the Group, Farsons ought to increase its payout ratio going forward. Should Farsons maintain a prudent payout ratio of approximately 30%, income-oriented investors whose prime objective is that of generating higher levels of income from their investment portfolio ought to consider alternative investment opportunities.**

KEY FINANCIAL HIGHLIGHTS & METRICS

Simonds Farsons Cisk plc *for the financial years ended 31 January*		*Actual* *12 months* **2015/16**	*Actual* *12 months* **2016/17**	*Pro-Forma* *12 months* **2016/17**	*Actual* *6 months* **2017/18**	*Forecast* *12 months* **2017/18**
Revenue *[€000]*		86,033	88,119	88,119	49,205	91,097
EBITDA *[€000]*		17,383	19,262	18,572	n/a	19,184
Operating Profit *[€000]*		11,475	12,852	12,185	6,838	11,757
Net Profit from Continuing Operations *[€000]*		10,981	11,858	11,114	5,716	10,098
Total Assets *[€000]*		162,573	182,941	151,679	197,040	162,524
Total Net Debt *[€000]*		24,388	35,195	42,151	n/a	48,071
Total Shareholders' Funds *[€000]*		109,459	123,271	87,190	126,764	94,193
Earnings per share *[€]*	*(Net Profit / Number of Shares in Issue)*	€0.3660	€0.3953	€0.3705	€0.1905	€0.3366
Net Dividend per share *[€]*	*(Net Dividend / Number of Shares in Issue)*	€0.1066	€0.1133	€0.1133	€0.0333	n/a
Payout Ratio *[%]*	*(Net Dividend / Earnings per share)*	29.1%	28.7%	30.6%	17.5%	n/a
Net Asset Value per share *[€]*	*(Total Equity / Number of Shares in Issue)*	€3.649	€4.109	€2.906	€4.225	€3.140
EBITDA Margin *[%]*	*(EBITDA / Revenue)*	20.2%	21.9%	21.1%	n/a	21.1%
Operating Profit Margin *[%]*	*(EBIT / Revenue)*	13.3%	14.6%	13.8%	13.9%	12.9%
Net Profit Margin *[%]*	*(Net Profit / Revenue)*	12.8%	13.5%	12.6%	11.6%	11.1%
Post-Tax Return on Equity *[%]*	*(Net Profit / Average Equity)*	10.7%	10.4%	11.3%	9.7%	11.1%
Post-Tax Return on Assets *[%]*	*(Net Profit / Average Assets)*	7.2%	7.0%	7.1%	6.3%	6.4%
Net Debt to EBITDA *[times]*	*(Net Debt / EBITDA)*	1.4x	1.8x	2.3x	n/a	2.5x
Gearing Ratio *[%]*	*(Total Debt / Total Debt and Equity)*	19.7%	22.6%	33.0%	n/a	34.4%

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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
This investment research report ("Report") was prepared by Josef Cutajar, a Research Analyst at Rizzo, Farrugia & Co (Stockbrokers) Ltd ("Rizzo Farrugia") and reviewed by Christopher Mallia, Head of Research, and Edward Rizzo, a Director at Rizzo Farrugia which is a member of the Malta Stock Exchange and licensed to conduct Investment Services business by the Malta Financial Services Authority.

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