Power Root Bhd

A Fine Brew

We are initiating coverage on PWROOT with an OUTPERFORM call and TP of RM2.90 based on a FY18E PE valuation of 17.0x. We see potential in the stock, driven by its growing export segment and expansion plans on the Middle East and North Africa market. In addition, we expect the stock to fetch decent dividend yields of above 4%.

PWROOT closed FY16 with core PATAMI of RM51.6m (+11% YoY, after adjusting for write-offs and impairments of RM8.1m). The better performance was driven by stronger sales (+11% YoY) on recovering domestic sales and growing export demand alongside margin expansions from favorable USD exchange rates. Dividends paid for FY16 amounted to 11.0 sen per share or c.65% of core earnings. Comparatively, 10.0 sen per share was paid out in FY15 at a similar pay-out ratio.

Exports to take the lead. With the impressive organic sales growth generated by exports, we opine that the group will continue to see an expansion from the segment, spearheaded by the Middle East and North Africa (MENA) market, which accounts for c.78% of export sales. We based this on its higher population base as well as higher standard of living to boost a greater propensity for consumption. In addition, the group's leading market position in the MENA market may suggest that brand awareness is well rooted with consumers and hence, should experience sustainable demand.

Delay in UAE plant but prospects are still intact. The tentative completion date of the new UAE plant was postponed from Mar 2017 to 2019, following management's decision to defer the commencement of construction of the plant. Given that construction costs will be incurred in USD, the prevailing strength in USD rates may lead to the loss of its net beneficiary position. While the delay may defer any aggressive growth strategies in the MENA region, we are hopeful that its market share would continue to expand from its resilient demand. Further, we believe the group may be better positioned from securing a wider market share before commissioning the new facility as a larger revenue stream could minimise risks of being overran by large-than-expected overheads. While the Johor plant is running at a utilisation rate of c.85%, we believe the group is able to accommodate future demand growth by ramping up production days.

Strained by commodity prices. Following the normalization of commodity prices (primarily coffee and sugar, the group is likely to face pressures in their profit margins in the short term due to the lack of hedging policies. On the other hand, **assuming input costs remain constant, the group will benefit from stronger USD exchange rates** given its sizeable exposure to exports. Exports account for c.40%-45% of total sales, of which c.90% are transacted in USD rates.

Looking forward, we estimate core PATAMI earnings for FY17 to see a slight decline at RM48.9m (-5% YoY) amidst higher production cost pressures. However, we expect a recovery in FY18 to RM52.6m (+7% YoY) arising from higher export sales. Dividend-wise, assuming a pay-out ratio of c.70%, we could potentially see payments of 11.0 sen/12.0 sen a share which translates to 4.2%/4.5% yield.

Initiating coverage with an OUTPERFORM call and TP of RM2.90. Our TP is based on the ascribed 17.0x PER on FY18E earnings per share of 17.0 sen, representing +2SD-level above the stocks 2-year average Fwd. PER. We believe a higher valuation premium should be ascribed on this stock given the increase in export exposure.

Currently, OLDTOWN trades at an implied FY17E/FY18E PERs of 21.8/19.1x while PWROOT trades at 16.8x/15.6x, respectively. Besides, we believe PWROOT appears to be attractive given its better dividend yield (FY18E: 4.5% vs OLDTOWN's 2.9%) and ROE ratio (FY18E: 20.0% vs OLDTOWN's 17.6%).

OUTPERFORM

Price:	**RM2.65**
Target Price:	**RM2.90**

Expected Capital Gain:	*RM0.25*	*+9.4%*
Expected Divd. Yield:	*RM0.12*	*+4.5%*
Expected Total Return:	*RM0.37*	*+13.9%*

KLCI Index **1771.01**

Stock Information

Bloomberg Ticker	PWRT MK Equity
Bursa Code	7237
Listing Market	Main Market
Shariah Compliant	Yes
Issued shares	323.5
Market Cap (RM m)	857.2
Par value per share (RM)	0.20
52-week range (H)	2.75
52-week range (L)	1.95
Free Float	42%
Beta	0.5
3-mth avg daily vol:	201,679

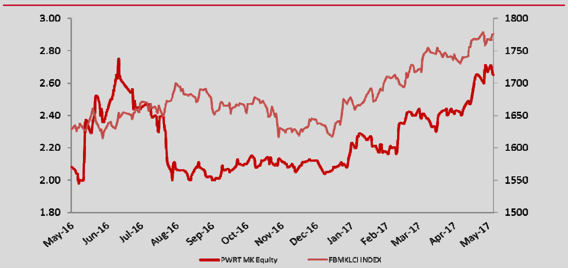
Major Shareholders

Low Chee Yen	20.0%
How Say Swee	19.6%
Wong Fuei Boon	18.8%

Summary Earnings Table

FY Mar (RM m)	2016A	2017E	2018E
Turnover	367.5	406.0	443.9
EBIT	43.4	54.8	58.7
PBT	44.4	55.7	59.5
Net Profit	**45.2**	**51.8**	**55.3**
Core PATAMI	**51.6**	**48.9**	**52.6**
Consensus (NP)	-	-	-
Earnings Revision	-	-	-
Core EPS (sen)	16.7	15.8	17.0
Core EPS growth (%)	11.2%	-5.2%	7.4%
NDPS (sen)	11.0	11.0	12.0
NTA per Share (RM)	0.77	0.82	0.87
Price to NTA (x)	3.5	3.2	3.1
PER (x)	15.9	16.8	15.6
Debt-to-Equity ratio (x)	(0.3)	(0.2)	(0.2)
Return on Asset (%)	13.5%	14.7%	14.9%
Return on Equity (%)	18.6%	20.0%	20.2%
Net Div. Yield (%)	4.2%	4.2%	4.5%

Share Price Performance



	1 mth	3 mths	12 mths
Absolute (%)	*16.8%*	*-0.5%*	*27.4%*
Relative (%)	*16.5%*	*-4.1%*	*18.7%*

Clement Chua
clement.chua@kenanga.com.my
+603-2172 2635

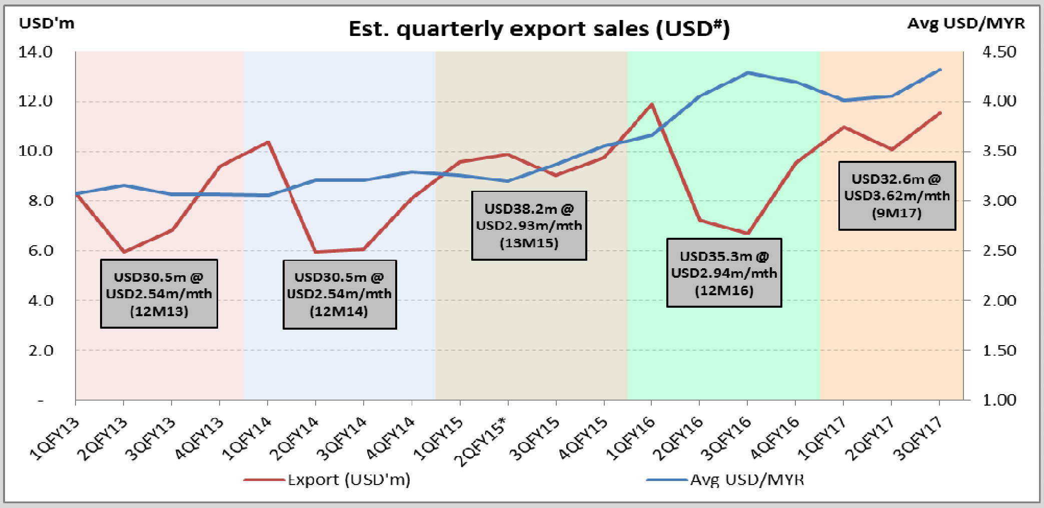
INVESTMENT MERITS

Organic growth in export demand. The group commenced its export operations in 2005. Since then, the results from the venture had proven to be rewarding with the group gaining exposure to a significantly broader market through a network of regional distributor clients. Breaking down the group's revenue, we gather that its export segment generated a 5-year CAGR of 36.5% whereas its domestic segment only registered a 5-year CAGR of 7.9%.

It was guided that c.90% of export sales are transacted in USD. While the group benefited from the strengthening of USD rates on top-line performance since 2015, we also attribute its encouraging results to constant organic volume growth. Based on the average exchange rates within their respective periods, we estimate that the group had generated export sales of c.USD2.54m/month in FY13 while the YTD 9M17 registered estimated translated sales of c.USD3.62m/month. Going forward, we reckon that the group's export demand growth is sustainable driven by the vibrant demand for its coffee products (c. 83% of group revenue) in the Middle East and North Africa (MENA) region. Typically, the second quarter of the financial year is weaker due to the fasting month of Ramadan. It is noted that the demand for group products are fairly segmented, whereas the "Alicafé" brand being favoured in MENA while the "Ah Huat" brand is seeing better reception in the Asia-Pacific region.

Export sales analysis

	FMCG Revenue (RM'm)					
Financial Year	**Domestic**	**YoY Chg**	**Export**	**YoY Chg**	**Total**	**YoY Chg**
FY11	155.0	-	29.8	-	184.8	-
FY12	170.8	10.2%	46.2	55.0%	217.0	17.4%
FY13	185.3	8.5%	94.0	103.5%	279.3	28.7%
FY14	210.0	13.3%	96.8	3.0%	306.8	9.8%
FY15*	203.0^	-3.3%	123.9	28.0%	326.9	6.6%
FY16	226.0	11.3%	141.5	14.2%	367.5	12.4%
5-year CAGR	**7.8%**		**36.6%**		**14.7%**	
5-year average		**8.0%**		**40.7%**		**15.0%**

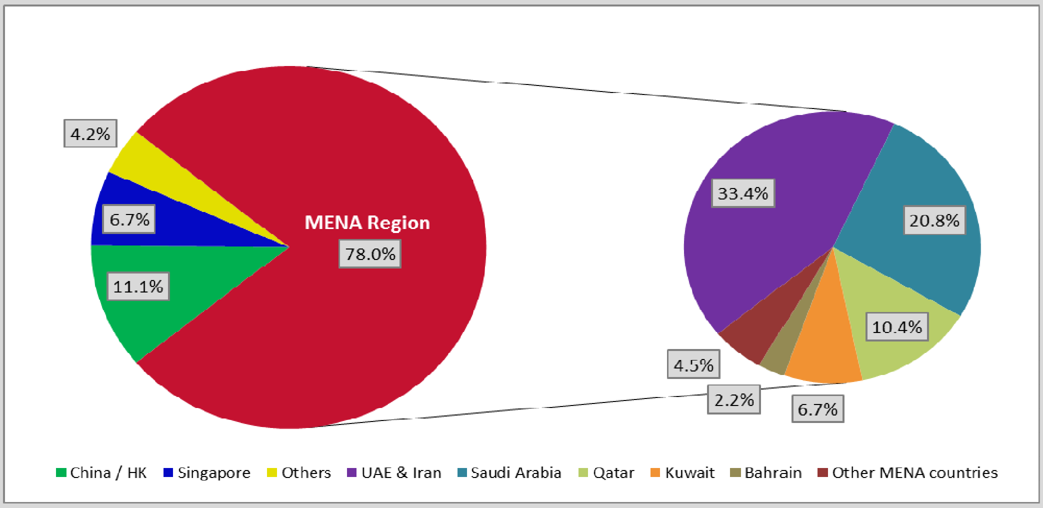


** change in FY-end from Feb to Mar*
^ domestic revenue is exclusive of one-off Property Development income of RM56.3m
 # assuming export sales were transacted entirely in USD

Source: Company, Kenanga Research

Vibrant demand from the MENA region. Based on the recent 9M17 results, management provided that c.78% of group exports are derived from the MENA region. With reference to the group's largest market in the region (i.e. UAE, Saudi Arabia, Iran, Qatar, Kuwait and Bahrain), the region has an estimated population base of c.50 million with an average GDP per capita of c.USD28,000 as compared to Malaysia's population of c.30 million and average GDP per capita of c.USD9,800 *(Source: World Bank)*. On top of the higher spending power within this region, studies have indicated that the MENA population has a higher propensity to spend on coffee products against other goods. According to an article by the 'International Comunicaffe', an extract from a study conducted by Euromonitor International estimated that in 2015, the UAE market had individually spent c.USD544.5m on coffee products, a 10% growth from the previous year. We expect export demand to be driven primarily from countries in this region as other markets (i.e. China, Hong Kong, Singapore) are expected to face stiffer competition due to the higher concentration of other coffee FMCG players.

Estimated export distribution based on 9M17 sales



Source: Company, Kenanga Research

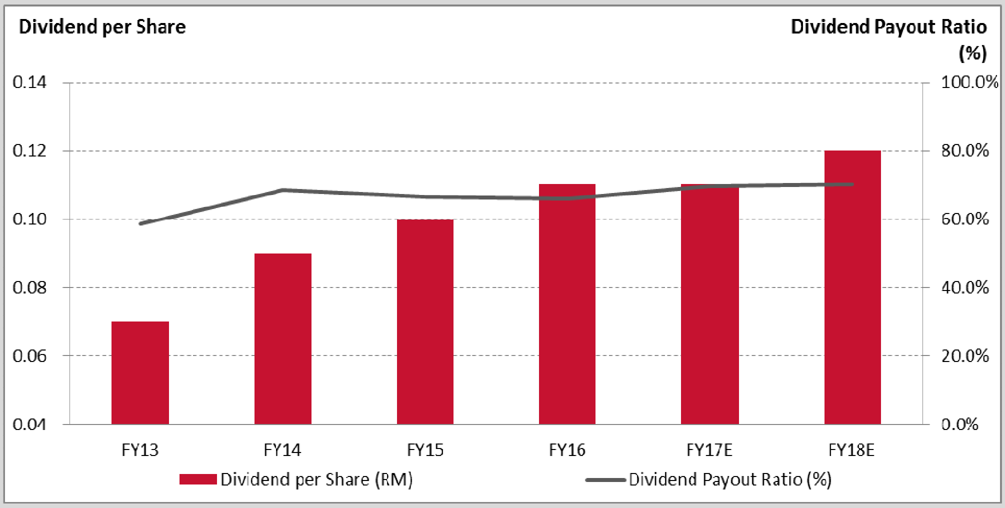
Construction of UAE production plant in the pipeline. With the growing demand garnered from the MENA region, the group has invested in establishing its second manufacturing facility in the UAE. The new plant should allow for better cost management and more efficient product delivery. Further, we believe that a nearer facility will enable the group to accommodate to the various product differentiations which may be preferred within the region while benefiting from savings in the way of lesser import duties.

We believe that the benefits of the new UAE plant extend beyond servicing the MENA region, as it also allows the group to direct its local capacity towards untapped markets in the Asia-Pacific region which is closer to home. The expected completion date of the UAE plant is at mid 2019. The UAE plant is expected to have a production capacity of c.130,000 cartons/month of instant products. The current utilisation rate of the existing production plant at Johor is estimated to be at c.85% on the production capacity of c.180,000 cartons/month of instant products and c.160,000 cartons/month of ready-to-drink products.

Solid cash position and attractive dividends. As of the latest 9M17 financial statements, PWROOT has a net cash position of RM56.6m after considering RM13.1m of debt. With operating cash flows forecasted to register between RM35.1m-RM59.0m for FY17E-FY18E, the group has sizeable capacity to fund its UAE plant along with other expansion plans or to reward its shareholders.

Dividend-wise, we noted that PWROOT had been consistently paying dividends on a quarterly basis since FY15. While management guided that it has a 50% minimum dividend pay-out policy of total net earnings, we gathered that the group had been paying dividends consistently at close to c.70% of core PATAMI since FY14. Assuming the same pay-out ratio in FY17E/FY18E, we expect to see dividend payments of 11.0 sen/12.0 sen, which imply a dividend yield of 4.2%/4.5%.

Dividend per share and estimated payout ratio



Source: Company, Kenanga Research

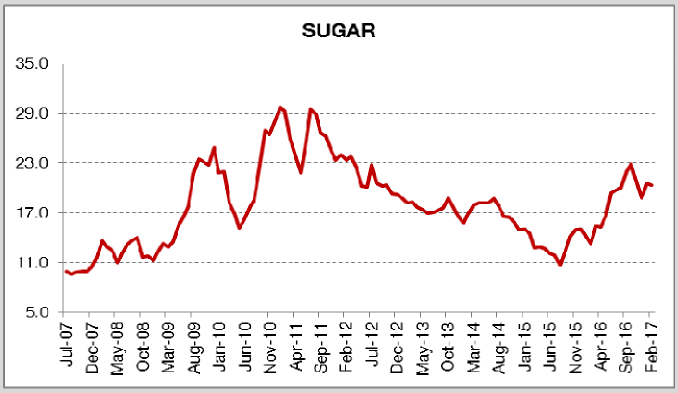
COMPANY OUTLOOK

Facing pressures from commodity prices. We understand that the primary commodities in the production of PWROOT products are: (i) coffee; (ii) milk products; and (iii) sugar, which collectively make up c.85% of raw material costs. The prices of these commodities underwent a phase of softness from 2014 to 2016, which until recently has been seeing a recovery to its normal mid-range prices, with the exception of milk powder prices. However, the group did not enjoy cost savings during this period, owing to the neutralising impact of higher forex rates (mainly USD rates). As such, raw material costs had consistently trailed at c.43%-45% of total revenue. Going forward, we expect input costs to inflate by some degree arising from the double pressures from both: (i) normalisation in commodity prices, and (ii) weak of local currency.

Milk Powder Prices

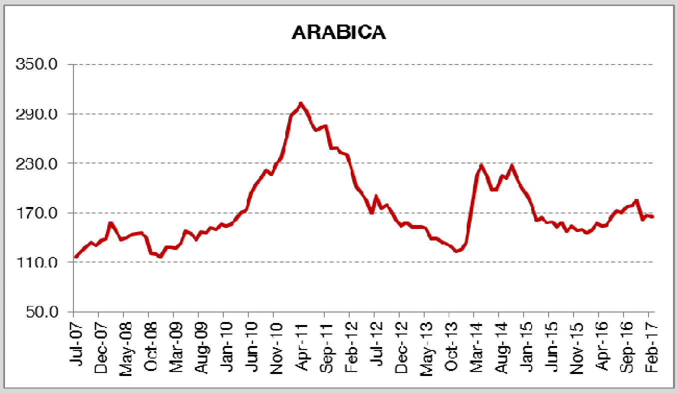
Source: Global Dairy Trade, Kenanga Research

Sugar Prices



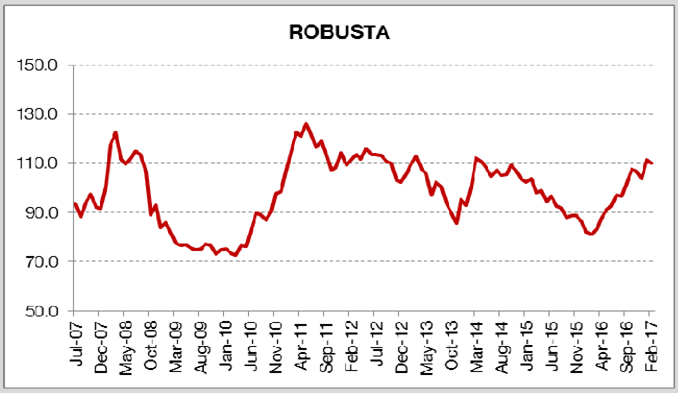
Source: Indexmundi, Kenanga Research

Coffee (Arabica) Prices



Source: Indexmundi, Kenanga Research

Coffee (Robusta) Prices



Source: Indexmundi, Kenanga Research

Existing capacity should sufficiently cater to demand growth. The Johor production plant has been the sole production facility to cater for both its domestic and export markets. Though presently producing at a relatively high utilisation rate of c.85%, we do not believe the group will face production constraints in the near future in the event of a sudden surge in demand as they are capable of ramping up production days. To recap, the group has a production capacity of c.180,000 cartons/month of instant products and c.160,000 cartons/month of ready-to-drink products. The group had recorded a 5-year revenue CAGR of c.15%.

Net beneficiary from strong USD. In terms of forex, the group is primarily exposed to USD rates, where c.30% of raw materials are imported while c.90% of exports (i.e. c.40%-45% of total sales) are denominated in that currency. Hence, we believe the group will yield a net gain from their transactions, expanded by any further strengthening in USD rates. Adding to this, any correction in USD rates will not be detrimental to the group as it would ease input costs, notwithstanding a significant upward trend in commodity prices.

New product developments for different preferences. An advantage of operating within a few specialty products is that a company is able to transfer and allocate resources into the development and manufacturing of new product variants without incurring much additional capital expenditure. Given the FMCG nature of business where manufacturers have to continuously adapt to seasonal factors, trends and changes in consumer preferences, we believe that PWROOT is well-positioned to deliver new offerings to its broad domestic and export markets on the back of the group's experience and know-how. This could be further leveraged as a means to enter new markets where design and preferences may differ slightly but still within the parameters of the group's core expertise. Recent products launches include the French Roast variant as well as jar-based coffee powder for the MENA market.

SECTOR OUTLOOK

Domestic market. The local market is expected to be challenging as consumer sentiment readings demonstrate persistent weakness. While the group had registered a 5-year domestic revenue CAGR of c.8%, competition is looking to be increasingly intense as market players are expected to be more aggressive in maintaining market share. On the other hand, the new Price Control and Anti Profiteering Regulation 2016 is likely to present another hurdle for F&B players whereby price mark-ups are limited to products' trailing historical 3-year gross margins or in accordance to its margin growth trends. While the group has not expressed any intentions to raise prices to keep gross margins sustainable, there could be risk as a prolonged state of cost absorption may be detrimental to their ability to pass down costs in the future as a low margin base becomes a new average.

Export market. Going forward, we believe exports will continue to be dominated by the MENA market on the back of its larger and wealthier population. In addition, as the group is able to hold a leading market position in the region, short from an international heavyweight brand, we do not anticipate a sudden decline in demand in the short to medium term given its strong brand acceptance. At the meantime, we expect other major markets from the Asia-Pacific region to be more competitive from a greater concentration of competitors (even from local players) and more pricey advertising costs, especially in areas of higher density. While we expect sales growth from this region to be flattish in the short term, we believe that there is still potential in this region in the mid to long term for its significantly larger population base and reckon that wider brand awareness could still materialise from maintaining a firm market presence, being accelerated by aggressive marketing strategies.

FINANCIAL ANALYSIS

Historical review – FY16

(Note: FY15 recorded property development income and operating profit of RM56.3m and RM18.0m, respectively. We have removed these components to illustrate the performance of the group's principal FMCG operations)

The group registered FMCG sales of RM367.5m, which grew 22% YoY on an annualised 13MFY15. This was the accumulation of: (i) stronger domestic sales of RM226.0m (+21% annualised YoY) with the recovery of weak demand from FY15's drag by heavy pre-GST forward buying; and (ii) better export sales of RM141.5m (+23% annualised YoY) arising from more favourable average USD rates (indicative averages in FY16: RM4.048 vs FY15: RM3.347) in the MENA market. We estimated that sales in the region was flattish at USD35.3m in FY16 (<1% growth). In FY16, coffee products accounted for c.82% of group product mix, followed by energy drinks products for c.8%, tea products at c.6% and chocolate products for c.4%.

On the core EBITDA level, FY16 rose to RM50.2m (+34% annualised YoY) with wider margins of 13.7% (+1.3 pts YoY) from the strengthening USD rates which supported export results. The group was likely to have also benefitted from cheaper average raw material prices. Core commodities for production, being coffee, milk and sugar, registered a cheaper indicative average of c.20% in FY16 as opposed to FY15 *(Source: IndexMundi)*. The year concluded with core PATAMI earnings of RM51.6m (+20% YoY), subsequent to adjusting for write-offs and impairments amounting to RM8.1m.

Dividend-wise, a total of 11.0 sen dividend per share was paid during this financial year, translating to c.65% pay-out from core earnings. Comparatively, FY15 paid 10.0 sen dividend per share, similarly at c.65% pay-out ratio of core earnings.

On key balance sheet items, account receivables expanded (+18% YoY to RM117.0m) concurrent with better revenue generated during the year, also leading to an increase in average receivables turnover days to c.116 days from c.94 days in FY15. Account payables, on the other hand, grew by 14% to RM73.7m, likely at a smaller quantum against receivables due to the group's net beneficiary position of higher USD. Average payable turnover days are consistent with the increase, recording at c.73 days from c.62 days in FY15.

Historical review – 9M17

In the latest 9M17, the group achieved a turnover of RM307.7m (+10% YoY), driven by a 33% growth in exports numbers to RM134.7m. While average USD rates in the 9M17 strengthened (indicative average in 9M17: RM4.128 vs 9M16: RM3.999), the better performance is also attributed to the organic growth in export sales, which is estimated to stand at USD32.6 (+26%) from the expanding coffee segment in the MENA region. Domestic sales, on the other hand, saw a flattish decline to RM173.0m (-2% YoY) as consumer sentiment saw a state of prolonged weakness from higher living expenses.

On the operating level, EBITDA only grew by 4% YoY to RM45.2m with a thinner margin at 14.7% (-0.9 pts YoY). We believe this to be a mix of more aggressive promotional activities to support the softening domestic demand in addition of the higher input costs. During this period, indicative average coffee and milk prices had risen by c.8% while sugar prices could have potentially increased by c.50% *(Source: IndexMundi)*. Adjusting for the higher tax provisions and reversals of impairments, 9M17 core PATAMI closed at RM32.9m (-18% YoY).

Dividend-wise, a total of 7.5 sen dividend per share was paid in the 9-month period for a pay-out ratio of c.65%.

Looking at its 9M17 balance sheet, the group saw an enlarged account receivable of RM159.4m and account payable of RM98.9m, +36% and +34% since FY16, given the stronger sales recorded in the period. Inventory levels have been fairly constant at RM44.6m from RM47.0m in FY16, suggesting production levels are fairly optimal against higher earnings.

Forecast assumptions

We estimate FY17E to record a full-year sales of c.RM406.0m (+11% YoY) as we anticipate growth momentum to be supported by strengthening exports. Following this, EBITDA is estimated to record at c.RM61.7m (+6% YoY) though with slightly thinner margins at 15.2% (-0.6 pts YoY) as rising commodity prices put a strain to input costs. Considering normalised tax expenses, we expect FY17E to close at a core PATAMI of c.RM48.9m (-5% YoY).

For FY18E, flattish domestic revenue growth with solid organic export growth (predominantly in the MENA region) alongside higher USD rate assumptions could potentially drive revenue. While management aspires to maintain a solid double-digit sales growth, we take a slightly conservative stance for FY18E sales to stand at c.RM443.9m (+9% YoY). We also expect EBITDA margin to come off slightly at c.15.0% (-0.2 pts YoY) or c.RM66.6m (+9% YoY) from further rises in raw material costs, though cushioned by the group's higher export exposure. This would derive core PATAMI of c.RM52.6m (+7% YoY).

Dividend-wise, we assume dividend pay-out of c.70% following historical trends since FY14. This translates to dividend pay-out of 11.0 sen /12.0 sen per share or 4.2%/4.5 yield for FY17E/FY18E, respectively.

Gearing analysis

The group holds a stable net cash position (with gearing ratios of -0.25x in FY16 and -0.24x in FY15), likely arising from the delay of the construction of the MENA plant which could potential cost USD13.0m-USD14.0m. Going forward, while we expect heavy capex to be incurred in FY18E/FY19E as a result of this, we believe the group would still sustain a net cash position RM47.6m/RM37.0m at a net gearing of -0.18x/-0.13x, respectively, backed by its large cash reserves with stable operating cash inflow.

PEER COMPARISON

Within our coverage, we believe OLDTOWN is PWROOT's closest peer, given their similarities in business models for the manufacturing and trading of instant coffee and ready-to-drink products. Comparative to OLDTOWN, PWROOT trades relatively cheaper in Fwd. PER terms (FY18E PER of 15.5x vs OLDTOWN's 19.7x, or 20% discount). We find the stock attractive in this sense as PWROOT looks to command a stronger dividend yield across its peers while also at a higher Fwd. ROE against OLDTOWN. At the same, other valuations such as PBV and Forward ROA for these coffee manufacturers appear to be at par, likely attributed to the nature of business.

Industry Peers – Valuations Comparison

Company	Price (RM)	Market Cap (RM'm)	PER (x)			PBV (x)			Fwd Div. Yield		Fwd ROE	Fwd. ROA	Target Price (RM)	Rating
			FY16A	FY17E	FY18E	FY16A	FY17E	FY18E	FY17E	FY18E				
PWROOT	2.67	863.7	16.0	16.9	15.5	3.5	3.3	3.1	4.1%	4.5%	20.0%	14.7%	2.90	OP
Core F&B Coverages														
DLADY	57.84	3,701.8	24.8	25.6	23.3	22.4	23.6	24.8	4.1%	4.5%	89.8%	29.9%	55.45	MP
NESTLE	81.98	19,224.3	30.2	28.4	27.4	29.7	29.3	29.8	3.5%	3.7%	104.0%	27.3%	83.90	MP
OLDTOWN	3.26	1,510.2	27.6	22.6	19.7	4.0	3.6	3.3	1.8%	2.8%	17.6%	14.2%	2.64	MP
QL	4.86	6,065.4	28.9	26.1	24.1	3.5	3.2	2.9	1.2%	1.3%	12.8%	7.4%	4.34	UP
Average			**27.9**	**25.7**	**23.6**	**14.9**	**14.9**	**15.2**	**2.7%**	**3.1%**	**56.1%**	**19.7%**		
Non-Core F&B Coverages – Exporting FMCGs														
KAWAN	4.67	1,259.2	38.2	33.7	31.0	4.3	4.0	3.8	1.3%	1.5%	12.4%	10.3%	4.52	NR
SPRITZER	2.50	456.5	8.6	11.9	11.0	1.8	1.7	1.6	2.2%	2.2%	10.4%	8.0%	2.53	NR
Average			**23.4**	**22.8**	**21.0**	**3.1**	**2.9**	**2.7**	**1.8%**	**1.9%**	**11.4%**	**9.2%**		

Note:
** Based on the closing prices of our cut-off date on 19 May 2017*

Source: Company, Kenanga Research

On fundamentals perspective, PWROOT's revenue growth is expected to be closely in line with that of our core coverage universe but below OLDTOWN, given OLDTOWN's more aggressive expansion plans in both its café chain and manufacturing business. On net profit terms, OLDTOWN is also expected to outpace PWROOT in terms of growth and margins on the back of its lower cost of goods sold as well as general operating expenses.

Industry Peers – Fundamentals Comparison

Company	Price (RM)	Market Cap (RM'm)	Revenue (RM'm)			Core Net Profit (RM'm)			Revenue Growth		Core Net Profit Growth		Net Profit Margin		
			FY16A	FY17E	FY18E	FY16A	FY17E	FY18E	FY17E	FY18E	FY17E	FY18E	FY16A	FY17E	FY18E
PWROOT	2.67	863.7	367.5	406.0	443.9	51.6	49.0	53.2	10.5%	9.4%	-5.1%	8.7%	14.0%	12.1%	12.0%
Core F&B Coverages															
DLADY	57.84	3,701.8	1,047.7	1,105.3	1,173.9	149.1	144.6	159.2	5.5%	6.2%	-3.0%	10.0%	14.2%	13.1%	13.6%
NESTLE	81.98	19,224.3	5,063.5	5,291.4	5,460.7	637.1	677.9	702.7	4.5%	3.2%	6.4%	3.7%	12.6%	12.8%	12.9%
OLDTOWN	3.26	1,510.2	393.4	445.5	494.4	52.3	63.9	73.1	13.2%	11.0%	22.2%	14.4%	13.3%	14.3%	14.8%
QL	4.86	6,065.4	2,853.9	3,172.4	3,365.7	192.1	212.6	230.2	11.2%	6.1%	10.7%	8.3%	6.7%	6.7%	6.8%
Average									**8.6%**	**6.6%**	**9.1%**	**9.1%**	**11.7%**	**11.7%**	**12.0%**
Non-Core F&B Coverages – Exporting FMCGs															
KAWAN	4.67	1,259.2	186.9	219.2	252.2	33.0	37.3	40.6	17.3%	15.0%	13.2%	8.7%	17.6%	17.0%	16.1%
SPRITZER	2.50	456.5	474.2	301.7	327.7	41.0	29.6	32.1	4.7%	8.6%	4.1%	8.3%	8.6%	9.8%	9.8%
Average									**11.0%**	**11.8%**	**8.7%**	**8.5%**	**13.1%**	**13.4%**	**13.0%**

Note:
** Based on the closing prices of our cut-off date on 19 May 2017*

Source: Company, Kenanga Research

VALUATION

We initiate coverage with an OUTPERFORM call and target price (TP) of RM2.90. Our TP is based on the ascribed 17.0x PER on FY18E earnings per share of 17.0 sen, which is closely inline with the +2SD-level above the stocks 2-year average Fwd. PER. While our current ascribed valuation of its coffee FMCG peer, OLDTOWN, stands at 16.0x, we believe a going premium should be ascribed on these stocks increasing export exposure, as demonstrated by FMCG stocks with increasing export exposure (i.e. KAWAN and SPRITZER which trade at close to +2SD of their 2-year average Fwd. PER). OLDTOWN was trading at an implied FY17E/FY18E PER of 21.8/19.1x while PWROOT trades at 16.8x/15.6x, respectively. With this, we believe PWROOT to be attractive given its better dividend yield (FY18E: 4.5% vs OLDTOWN's 2.9%) and ROE ratio (FY18E: 20.0% vs OLDTOWN's 17.6%). While the valuation is reflective of the stock's 2-year average Fwd. PER at +2SD, we believe the valuation is not excessive given its resilient earnings prospects stemming from its growing export exposure and solid net cash positioning.

RISKS

Higher-than-expected growth in commodity prices. While the group had generally incurred stable input costs as soft commodity prices had been neutralised by weak local currency, we could see inflationary pressures from here as commodity prices reach its average-normalised levels coupled by the continuing forex weakness. As such, group margins will be threatened by a continuing rise in commodity prices unless buffered by an improvement in forex rates. We estimate gross profit margins to linger at c.57% in FY17 and FY18.

Slowing demand from the MENA region. Although the UAE plant is only expected to be completed in 2HCY18, or FY19, we expect demand from the MENA region to continue to expand organically from the encouraging reception and resiliency of coffee products there. To recap, based on 9M17 results, the region accounts for c.78% of exports or c.35% of total sales. Given its significant exposure, our earnings estimates are susceptible to any weakness in demand from these markets going forward.

Prolonged factory downtime may affect sales. As the group is reliant on a single production facility which runs on a fairly high utilisation rate of c.85%, we believe the impact from a prolonged factory downtime may significantly affect its manufacturing output rate and hence sales turnover. The factory has the production capacity of c.180,000 cartons/month of instant products and c.160,000 cartons/month of ready-to-drink products.

APPENDIX

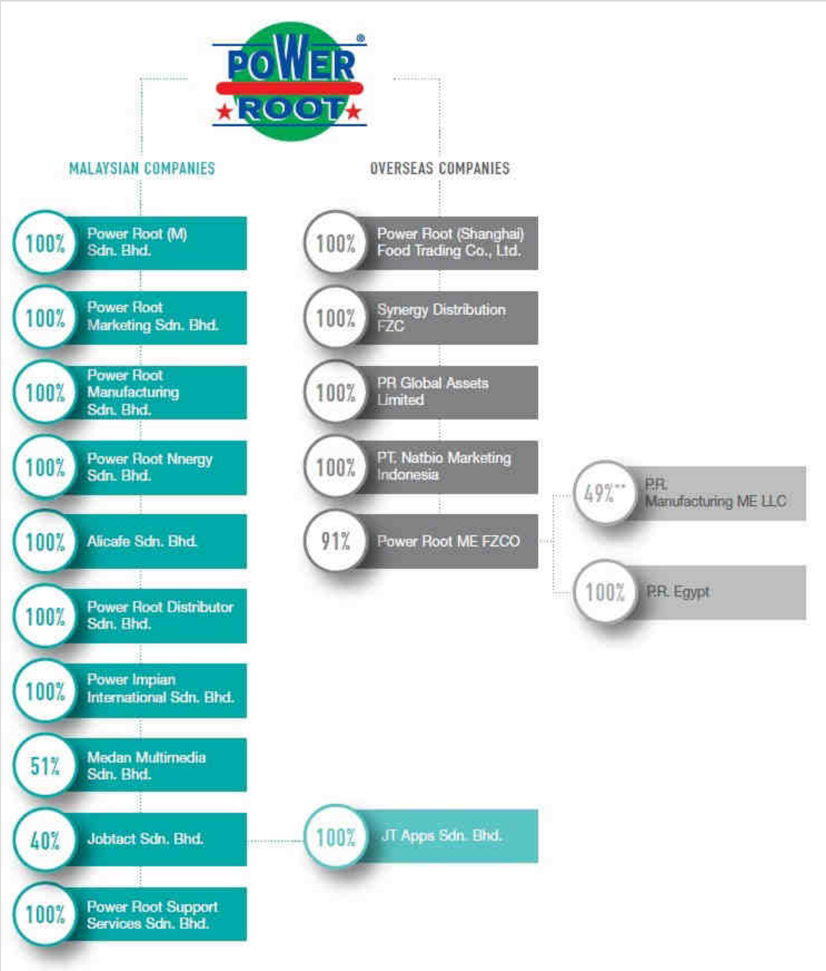
Company Background

Power Root (M) Sdn Bhd was founded on 23 July 1999 in Johor Bahru, Johor. It is a leading company in developing and promoting herbal energy drinks fortified with two main rainforest herbs: Eurycoma longifolia Jack or commonly known as "Tongkat Ali" and Labisia Pumilia and Pathoina or "Kacip Fatimah". These herbs are indigenous to Malaysia and its properties for promoting physical well-being are highly regarded by Malaysians.

Formerly known as Natural Bio Resources Bhd, Power Root Bhd has invested heavily in research and development of these traditional herbs to create its own brand of products. In March 2001, Power Root established a marketing branch in Kuala Lumpur to better coordinate its logistic and serve its customers more effectively. In 2003, Power Root started its very own manufacturing plant in Johor Bahru to cater to growing demands. An 18-acre phase manufacturing facility was completed in 2008, incorporating modern production technology to cater for the strong market demand locally, business development opportunities abroad and new formulations development.

The group has been exporting to the Middle East and North African (Mena) region since 2005, which has been demonstrating steady demand and growth potential. To support the demand from the region better, the group had invested in establishing its second manufacturing facility in the United Arab Emirates to allow for better cost management and product delivery efficiency while also allowing them to accommodate to the various preferred product differentiations within the region.

Group Structure



Source: Company

Board of Directors

Name	Position	Background
Dato' Tea Choo Keng	Alternate Director	• Appointed to the Board on 16 August 2016 after the resignation of Y.M. Tengku Shamsulbhari bin Tengku Azman Shah, SMK. (15 July 2016) • Held Law degree (LL.B Hons) from the University of Hull (United Kingdom). • Is currently the Managing partner of Messrs Tea, Kelvin Kang & Co, a legal firm in Johor Bahru
Dato' Low Chee Yen	Group Managing Director	• One of the founding members of the Power Root Group • Appointed to the Board on 02 February 2007 • Appointed as a member of the Remuneration Committee and Option Committee • Has vast experience in direct marketing, and producing drink concentrates • Has more than 16 years' working experience in the F&B industry
Dato' How Say Swee	Executive Director	• One of the founding members of the Power Root Group • Appointed to the Board on 02 February 2007 • Has vast experience in operating several retail outlets • Has more than 24 years' working experience in the food retailing business
Dato' Wong Fuei Boon	Executive Director	• One of the founding members of the Power Root Group • Appointed to the Board on 02 February 2007 • Has vast experience in owning and operating several mini-markets in Johor Bharu. • Has more than 28 years' working experience sales of consumer products (16 years in F&B industry)
See Thuan Po	Executive Director	• Appointed to the Board on 27 October 2007 • Appointed as a member of the Option Committee • Is currently a member of the Institute of Chartered Accountants of England and Wales • Started career in Auditing at Clarke & Co. Chartered Accountants London (3 years), and in Investment banking at CIMB Investment Bank Berhad (5 years).
Ong Kheng Swee	Independent Non-Executive Director	• Appointed to the Board on 15 February 2008 • Appointed as a Chairman of the Audit Committee, member of Remuneration Committee, and Option Committee • Appointed as member of Nomination Committee • Is currently Group Finance Director & Management Consultant in various industries including petrochemicals, ceramic tiles, automotive components, mineral and glass
Azahar Bin Baharudin	Independent Non-Executive Director	• Appointed to the Board on 28 April 2014 • Appointed as a member of the Audit Committee and Nomination Commiteee. • Has vast experience in the Banking and Finance field (with his tenure at 2 Malaysian financial institutions) and business development head & consultant in manufacturing and services sector • Is currently Independent Non-Executive Director of Solid Automotive Berhad and Gromutual Berhad
Dato' Afifuddin Bin Abdul Kadir	Independent Non-Executive Director	• Appointed to the Board on 16 August 2016 after the resignation of Y.M. Tengku Shamsulbhari bin Tengku Azman Shah, SMK. (15 July 2016) • Appointed as a Chairman of the Nomination Committee and Remuneration Committee • Appointed as a Member of the Audit Committee • Served in Malaysian Industrial Development Authority (MIDA) from 1979 until his retirement on 14 September 2011 as a Deputy Director General I of MIDA.

Source: Company

Business Overview

Product Portfolio

Power Root - canned energy drinks

Alicafé - powdered instant and canned coffee

Per'l Café - powdered instant and canned coffee

Ah Huat - powdered instant and canned coffee and chocolate beverage

Alitéa - powdered instant tea

Oligo - powdered and canned chocolate beverage

Source: Company

Income Statement

FY Mar (RM m)	2014A	2015A	2016A	2017E	2018E
Revenue	**306.9**	**383.2**	**367.5**	**406.0**	**443.9**
Core EBITDA	57.4	60.7	58.0	61.7	66.6
Operating Profit	50.1	51.4	43.4	54.8	58.7
Depreciation	-5.5	-6.3	-6.4	-6.9	-7.9
Interest Inc/(Exp)	-0.1	0.6	0.9	0.8	0.8
Profit Before Tax	**50.0**	**51.7**	**44.4**	**55.7**	**59.5**
Taxation	-10.3	-5.4	0.8	-3.9	-4.2
Net Profit	39.7	46.3	45.2	51.8	55.3
Core PATAMI	**40.7**	**46.4**	**51.6**	**48.9**	**52.6**

Balance Sheet

FY Mar (RM m)	2014A	2015A	2016A	2017E	2018E
Fixed Assets	75.4	80.2	76.4	77.0	99.1
Intangible Assets	5.3	4.9	0.1	0.1	0.1
Other Fixed Assets	2.3	3.1	5.7	5.7	5.7
Inventories	50.1	54.7	47.0	58.7	61.4
Receivables	107.8	98.8	117.0	125.5	131.0
Other Current Assets	31.7	7.4	8.6	8.6	8.6
Cash	46.4	67.5	71.4	65.8	58.5
Total Assets	**319.2**	**316.6**	**326.0**	**341.3**	**364.3**
Payables	54.8	64.6	73.7	74.1	81.6
ST Borrowings	12.4	12.5	10.3	10.3	10.3
Other ST Liability	26.4	1.4	0.1	0.1	0.1
LT Borrowings	1.0	0.8	0.6	0.6	0.6
Other LT Liability	2.2	2.3	1.1	1.1	1.1
Net Assets	**222.4**	**235.0**	**240.2**	**255.1**	**270.6**
Shareholders' Equity	220.7	230.7	237.6	252.5	267.9
Minority Interests	1.8	4.3	2.7	2.7	2.7
Total Equity	**222.4**	**235.0**	**240.2**	**255.1**	**270.6**

Cashflow Statement

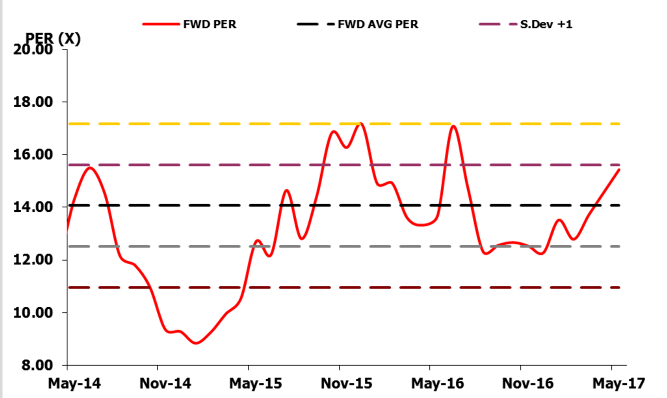
FY Mar (RM m)	2014A	2015A	2016A	2017E	2018E
Operating CF	36.4	66.1	48.1	35.1	59.0
Investing CF	-1.7	-8.4	-0.5	-7.5	-30.0
Financing CF	-25.4	-37.3	-44.0	-33.2	-36.3
Change In Cash	9.3	20.4	3.6	-5.5	-7.3
Free CF	30.5	55.3	43.2	27.6	29.0

Financial Data & Ratios

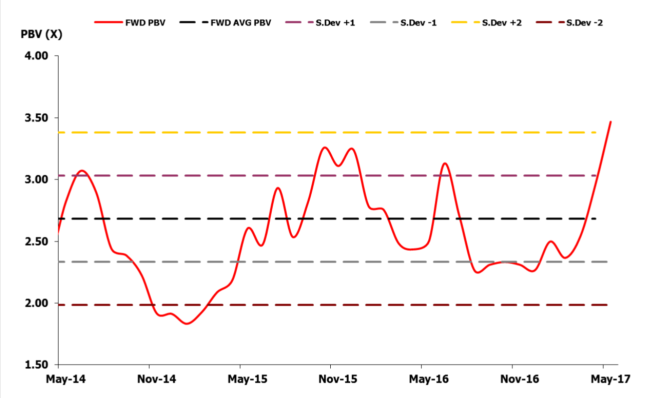
FY Mar (RM m)	2014A	2015A	2016A	2017E	2018E
Growth (%)					
Turnover	9.8%	24.9%	-4.1%	10.5%	9.4%
EBITDA	9.8%	24.9%	-4.1%	10.5%	9.4%
Operating Profit	19.7%	2.6%	-15.5%	26.2%	7.0%
PBT	19.2%	3.5%	-14.2%	25.4%	6.9%
Core PATAMI	10.3%	14.0%	11.2%	-5.2%	7.4%
Profitability (%)					
EBITDA Margin*	18.7%	15.8%	15.8%	15.2%	15.0%
Operating Margin	16.3%	13.4%	11.8%	13.5%	13.2%
PBT Margin	16.3%	13.5%	12.1%	13.7%	13.4%
Core Net Margin	13.3%	12.1%	14.0%	12.0%	11.8%
Effective Tax Rate	20.6%	10.5%	-1.9%	7.0%	7.0%
ROA	12.9%	13.7%	13.5%	14.7%	14.9%
ROE	18.3%	19.2%	18.6%	20.0%	20.2%
** Adjusted for write-offs and impairments*					
DuPont Analysis					
Net Margin (%)	13.3%	12.1%	14.0%	12.0%	11.8%
Assets Turnover (x)	1.0	1.2	1.1	1.2	1.2
Leverage Factor (x)	1.4	1.4	1.4	1.4	1.4
ROE (%)	18.3%	19.2%	18.6%	20.0%	20.2%
Leverage					
Debt/Asset (x)	0.0	0.0	0.0	0.0	0.0
Debt/Equity (x)	0.1	0.1	0.0	0.0	0.0
Net (Cash)/Debt	(33.1)	(54.2)	(60.5)	(54.9)	(47.6)
Net Debt/Equity (x)	(0.1)	(0.2)	(0.3)	(0.2)	(0.2)
Valuations					
Core EPS (sen)	13.2	15.0	16.7	15.8	17.0
NDPS (sen)	9.0	10.0	11.0	11.0	12.0
BV/sh (RM)	0.7	0.7	0.8	0.8	0.9
PER (x)	20.1	17.7	15.9	16.8	15.6
Div. Yield (%)	3.4%	3.8%	4.2%	4.2%	4.5%
PBV (x)	3.7	3.6	3.5	3.2	3.1
EV/EBITDA (x)	10.6	9.9	14.6	12.7	12.4

Source: Kenanga Research

Fwd Core PER Band



Fwd PBV Band



Source: Bloomberg, Kenanga Research

Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM	: A particular stock's Expected Total Return is MORE than 10%
MARKET PERFORM	: A particular stock's Expected Total Return is WITHIN the range of -5% to 10%
UNDERPERFORM	: A particular stock's Expected Total Return is LESS than -5%

Sector Recommendations***

OVERWEIGHT	: A particular sector's Expected Total Return is MORE than 10%
NEUTRAL	: A particular sector's Expected Total Return is WITHIN the range of -5% to 10%
UNDERWEIGHT	: A particular sector's Expected Total Return is LESS than -5%

*******Sector recommendations are defined based on market capitalisation weighted average expected total return for stocks under our coverage.****

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KENANGA INVESTMENT BANK BERHAD (15678-H)
Level 12, Kenanga Tower, 237, Jalan Tun Razak, 50400 Kuala Lumpur, Malaysia
Telephone: (603) 2172 0880 Website: www.kenanga.com.my E-mail: research@kenanga.com.my

Chan Ken Yew
Head of Research

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