



## FFI Holdings Limited (FFI)

## Market Perform

### Initiating Coverage

**\$3.40**

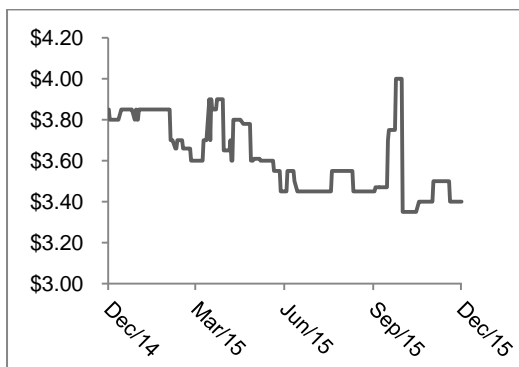
### Summary (AUD)

Market capitalisation (\$m)	\$33.6
Share price	\$3.40
52 week high	\$4.00
52 week low	\$3.35
Ave Monthly Vol (year rolling)	0.030m

### Key Financials (AUD)

Period	FY15 Act.	FY16 Est.	FY17 Est.
Revenue Adj. (\$m)	30.7	31.5	32.3
EBITDA Adj. (\$m)	4.0	4.3	4.5
EBIT Adj. (\$m)	3.5	3.6	3.8
NPAT Adj. (\$m)	2.4	2.5	2.6
<b>PE Ratio Adj. (x)</b>	<b>13.4</b>	<b>13.9</b>	<b>13.7</b>
EPS Adj. (c)	25.5	24.4	24.9
DPS (c)	19.0	20.0	20.0
<b>Div Yield</b>	<b>5.6%</b>	<b>5.9%</b>	<b>5.9%</b>
Franking	100.0%	100.0%	100.0%
<b>Payout ratio</b>	<b>83.8%</b>	<b>82.0%</b>	<b>80.4%</b>
EV (\$M)	34.1	35.8	34.0
EV/EBITDA (x)	8.4	8.3	7.5
EV/EBIT (x)	9.9	9.9	8.9
EBIT Margin Adj.	11.5%	11.8%	12.1%
ROE Adj.	8.1%	8.0%	8.0%

### Share Price Graph (AUD)



### Our View

FFI is evolving into a property developer with a niche food manufacturing division. We are attracted to unlocking further value from future property subdivisions, diversified manufacturing capabilities and sound balance sheet. A focus on innovation is also a positive and facilitates customer retention and growth opportunities.

Trading at 9.9x our FY16e EV/EBIT, we believe the current valuation trades close to our fair value estimate. FFI suits investors with a long investment horizon who are willing to accept an illiquid stock. We believe the next catalyst for meaningful growth in this stock is construction of the North Lake Road Bridge (some 5-10 years away). We initiate coverage with a Market Perform recommendation.

### Key Points / Investment Highlights

**Niche food manufacturer or property developer** – Strong land holdings in the rapidly growing Cockburn Industrial Precinct has swayed management from purely niche manufacturing to a dual focused property development play. This is evident by the October 2015 acquisition of further investment property adjoining the existing Cockburn site. Currently the investment property contributes 20% towards EBIT. We see key infrastructure projects comprising the North Lake Road Bridge and Verde Drive works as catalysts for both property subdivisions and increases in land values within the Group.

**Innovation ensures longevity** – We believe FFI's commitment to innovation and business partnering, instead of being pure commodity providers should ensure the longevity of the food manufacturing business. There is a risk that meaningful market penetration remains elusive for FFI given the small number of active sales staff. This aside, the vast array of manufacturing capabilities provides plenty of opportunities for innovation, which we believe protects the earnings of the business to some degree.

**Yield in the short term, growth in the long term** – FFI paid out 84% of FY15 earnings in dividends and appears set to continue to distribute the vast majority of earnings in future periods. Whilst a fully franked 5.9% FY16e dividend yield is a short term attraction, it pales in comparison to potential returns on land holdings post completion of North Lake Road Bridge and Verde Drive extension.

**Acquisitions possible** – The underlying food manufacturing business has consistently generated ~\$30m of sales since FY10. Whilst creating a solid base, growth has been lacking of late. We however note FFI has a rich history of acquiring complementary businesses to generate growth. With a healthy balance sheet and no meaningful acquisitions for some time, we see a complementary acquisition as both likely and appealing to generate business growth.



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## FFI Holdings Limited - Summary of Forecasts

Price \$ 3.40

PROFIT & LOSS SUMMARY (A\$m)				
Period	FY14A	FY15A	FY16E	FY17E
Operating Revenue	30.3	29.9	30.7	31.5
<b>Total Revenue Adj.</b>	<b>30.5</b>	<b>30.7</b>	<b>31.5</b>	<b>32.3</b>
Growth (pcp)	-1.9%	0.7%	2.8%	2.5%
<b>EBITDA Adj.</b>	<b>2.9</b>	<b>4.0</b>	<b>4.3</b>	<b>4.5</b>
Dep'n/Other Amort'n	(0.6)	(0.6)	(0.7)	(0.7)
<b>EBITA Adj.</b>	<b>2.4</b>	<b>3.5</b>	<b>3.6</b>	<b>3.8</b>
Amort'n of Goodwill	0.0	0.0	0.0	0.0
<b>EBIT Adj.</b>	<b>2.4</b>	<b>3.5</b>	<b>3.6</b>	<b>3.8</b>
Net Interest	(0.0)	(0.1)	(0.2)	(0.2)
<b>Pre-Tax Profit Adj.</b>	<b>2.4</b>	<b>3.4</b>	<b>3.5</b>	<b>3.7</b>
Tax Expense	(0.7)	(0.9)	(1.0)	(1.0)
Minorities	0.0	0.0	0.0	0.0
<b>NPAT Adj.</b>	<b>1.7</b>	<b>2.4</b>	<b>2.5</b>	<b>2.6</b>
Growth (pcp)	-42.9%	46.4%	3.2%	5.4%
Abnormals (net of tax)	1.6	(0.3)	0.0	0.0
<b>Reported Profit</b>	<b>3.2</b>	<b>2.2</b>	<b>2.5</b>	<b>2.6</b>

PER SHARE DATA				
Period	FY14A	FY15A	FY16E	FY17E
<b>EPS Adj (c)</b>	<b>18.4</b>	<b>25.5</b>	<b>24.4</b>	<b>24.9</b>
Growth (pcp)	-47.6%	38.3%	-4.3%	2.0%
Dividend (c)	42.5	19.0	20.0	20.0
Franking	100%	100%	100%	100%
Gross CF per Share (c)	7.7	37.7	28.6	31.4
NTA per share (c)	319	316	310	317
Weighted Shares on Issue (m)	9.0	9.5	10.2	10.6

KEY RATIOS				
Period	FY14A	FY15A	FY16E	FY17E
EBITDA/Sales Margin (%)	9.6%	13.5%	14.1%	14.4%
EBIT/Sales Margin (%)	7.8%	11.5%	11.8%	12.1%
EBIT Interest cover (x)	63.1	26.0	24.1	23.9
Current ratio (x)	2.7	2.8	2.4	2.4
Net Debt : Equity (%)	7.3%	1.6%	6.8%	0.9%
Adj. ROE (%)	6.0%	8.1%	8.0%	8.0%
Dividend Payout Ratio (%)	117.4%	83.8%	82.0%	80.4%

VALUATION MULTIPLES				
Period	FY14A	FY15A	FY16E	FY17E
<b>PE Ratio Adj (x)</b>	<b>18.5</b>	<b>13.4</b>	<b>13.9</b>	<b>13.7</b>
<b>Dividend Yield (%)</b>	<b>5.1%</b>	<b>5.6%</b>	<b>5.9%</b>	<b>5.9%</b>
Free CF Yield	-14.5%	6.3%	-2.5%	7.6%
EV/EBITDA (x)	12.3	8.4	8.3	7.5
EV/EBIT (x)	15.2	9.9	9.9	8.9

BALANCE SHEET SUMMARY				
Period	FY14A	FY15A	FY16E	FY17E
Cash	0.9	2.5	1.0	1.0
Receivables	4.0	3.7	4.0	4.1
Inventories	3.9	3.7	3.8	3.8
Other	0.3	0.2	0.2	0.2
<b>Total Current Assets</b>	<b>9.0</b>	<b>10.1</b>	<b>9.1</b>	<b>9.2</b>
Investment Properties	18.5	18.6	21.8	21.8
Property Plant & Equip	12.6	13.1	13.0	12.9
Intangibles	0.4	0.4	0.4	0.4
Other	0.4	0.4	0.4	0.4
<b>Total Non-Current Assets</b>	<b>32.1</b>	<b>32.7</b>	<b>35.8</b>	<b>35.7</b>
<b>TOTAL ASSETS</b>	<b>41.1</b>	<b>42.8</b>	<b>44.8</b>	<b>44.8</b>
Accounts Payable	2.5	2.6	2.7	2.8
Borrowings	0.0	0.0	0.0	0.0
Provisions	0.9	0.9	0.9	0.9
Other	(0.0)	0.2	0.2	0.2
<b>Total Current Liab</b>	<b>3.4</b>	<b>3.7</b>	<b>3.8</b>	<b>3.9</b>
Borrowings	3.0	3.0	3.2	1.3
Provisions	0.0	0.0	0.0	0.0
Other	5.7	5.7	5.7	5.7
<b>Total Non-Current Liab</b>	<b>8.7</b>	<b>8.7</b>	<b>8.9</b>	<b>7.0</b>
<b>TOTAL LIABILITIES</b>	<b>12.1</b>	<b>12.4</b>	<b>12.7</b>	<b>10.9</b>
<b>TOTAL EQUITY</b>	<b>29.0</b>	<b>30.4</b>	<b>32.1</b>	<b>33.9</b>

CASH FLOW SUMMARY				
Period	FY14A	FY15A	FY16E	FY17E
<b>EBIT (excl Abs/Extr)</b>	<b>2.4</b>	<b>3.5</b>	<b>3.6</b>	<b>3.8</b>
Add: Depreciation	0.6	0.6	0.7	0.7
Amortisation	0.0	0.0	0.0	0.0
Change in Payables	(0.6)	0.1	0.1	0.1
Change in Provisions	0.0	0.0	0.0	0.0
Change in Other Liabilities	(0.1)	0.2	0.0	0.0
Other non cash/unusual items	(0.7)	(0.3)	0.0	0.0
Less: Tax paid	(0.7)	(0.9)	(1.0)	(1.0)
Net Interest	(0.0)	(0.1)	(0.2)	(0.2)
Change in Receivables	0.1	0.3	(0.3)	(0.1)
Change in Inventory	(0.1)	0.2	(0.1)	0.0
Change in Other Assets	(0.1)	0.1	0.0	0.0
<b>Gross Cashflows</b>	<b>0.7</b>	<b>3.6</b>	<b>2.9</b>	<b>3.3</b>
Net Capex	(5.1)	(1.3)	(0.6)	(0.6)
(Acquisitions)/Divestments	0.0	(0.3)	0.0	0.0
Other investments	0.0	0.0	(3.2)	0.0
<b>Free Cashflows</b>	<b>(4.4)</b>	<b>2.0</b>	<b>(0.9)</b>	<b>2.7</b>
Dividends Paid	(0.7)	(0.5)	(2.0)	(2.1)
Debt issued/ (repaid)	3.0	0.0	0.0	0.0
Equity issued/ (buyback)	0.0	0.0	1.2	1.3
<b>Net Cash Flow</b>	<b>(2.1)</b>	<b>1.6</b>	<b>(1.7)</b>	<b>1.9</b>

### Notes

Abnormals (presented net of tax) are:

- FY14A: Revaluation on investment property for \$2.27m; and
- FY15A: Once of costs to upgrade chocolate manufacturing operations

## Longer Term Business Attractions

We believe the following factors will be key drivers of FFI's business and share price going forward:

### 1. Significant investment property held in rapidly developing Cockburn Town Centre

FFI holds approximately 84,000m<sup>2</sup> of property in the Cockburn Industrial Precinct. Approximately 59,000m<sup>2</sup> is held as an investment and 25,000m<sup>2</sup> utilised by the manufacturing business. The market value of investment property held represents \$2.20 per share (pre-tax). Inclusive of the manufacturing land and buildings, we estimate the total property holdings to be worth \$2.73 per share (pre-tax). We are attracted to the additional demand for these properties as well as additional subdivision opportunities post construction of the North Lake Bridge, connecting the Group's land holdings to Cockburn CBD.

### 2. Commitment to innovation keeps customers sticky

FFI has a vast array of manufacturing capabilities and a sales strategy which includes targeting end customers with new product developments and collaborative food scientist efforts to meet their needs. We believe this approach ensures customers remain sticky, as well as providing protection from competitor infiltration.

### 3. Flexible, quick moving and opportunistic

We understand that the Group has available production capacity across most lines. Management has stated whilst there is potential to increase sales additional bottom line growth remains constrained due to the competitive nature of the industry. The real value in food manufacturing lies with product development and innovation - moving with consumable demands. Where possible, production schedules are easily maneuverable, which provides added flexibility to customers. We are attracted to the quick moving, opportunistic and flexible nature of the underlying manufacturing business; which we believe underpins FFI's long term sustainability within niche food manufacture.

### 4. Balance sheet positioned for growth

A conservative approach to growth and debt management has contributed to the Group's strong balance sheet. Management has expressed its intention to grow the smallgoods business by way of acquisition of a complementary player in W.A, however, until now has been unsuccessful. Despite this, FFI is well positioned for acquisitive growth throughout its offerings, backed by the strength of its balance sheet. We forecast net debt of \$2.2m for FY16e with gearing ratio of 6.8% and EBIT interest cover at 24.1x.

### 5. Strong yield with excess franking credits

FFI has a history of paying fully franked dividends. We expect FY16e dividend yield to increase from 19 cents to 20 cents per share representing a dividend yield of 5.9% fully franked. FFI's small debt position should ensure the FY17e dividend payout remains steady at 20 cents per share, notwithstanding expected strategic acquisitions.

## Company Overview

FFI Holdings Limited (“FFI”) is a W.A. based food company which commenced operations in 1979. FFI first listed on the Australian Securities Exchange in 1986. FFI is one of Australia's leading specialised food manufacturing operations, providing ingredients, products and services to industries such as: Bakers and Pastrycooks, Ice cream and Dairy, Confectionery, Chocolate and Supermarkets.

FFI services all states of Australia as well as some South-East Asian markets, providing both fresh and extended shelf-life products.

The Company has evolved its food manufacturing over the years. Some key transactions that have shaped the core business include:

- In December 2000 the Company sold its W.A. frozen chip potato manufacturing business (acquired in 1995) for \$1.3m, in an effort to pay down debt and expand its remaining manufacturing businesses.
- In June 2003 the Company purchased certain assets and business operations of Sunrise Confectioners, expanding its manufacturing capabilities within cake toppings, boiled sweets and chocolates.
- In July 2005 the Company acquired Century Sweets which specialised in the manufacture of cake and confectionery decoration toppings (100's and 1000's).

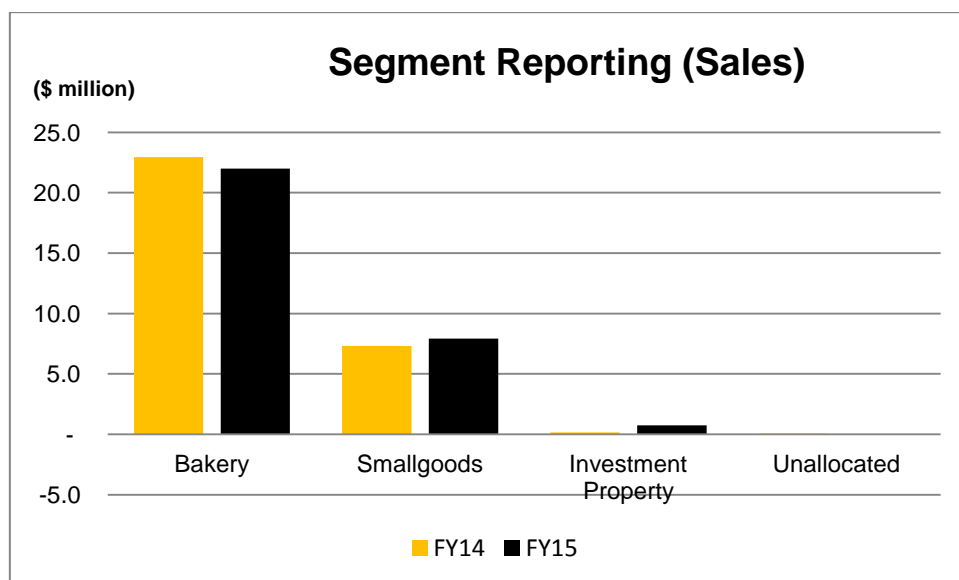
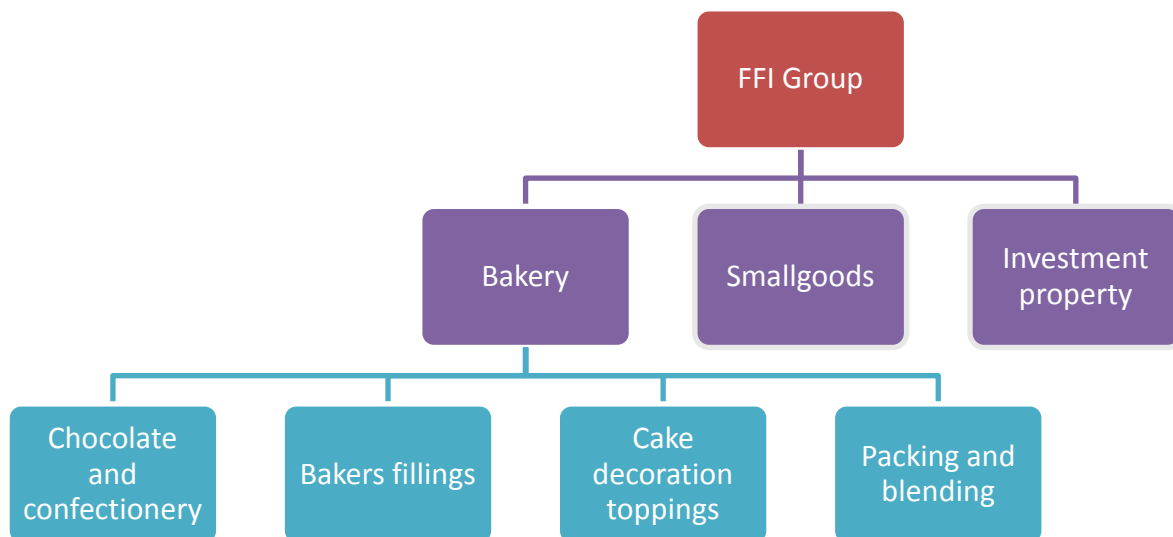
In November 2012 and April 2013 the Company sold approximately 8,000m<sup>2</sup> of subdivided land at its Cockburn site for ~\$3.1m. The funds were deployed towards building works to secure the 10 year Veolia lease on 18,000m<sup>2</sup>.

In October 2015 the Company acquired an additional 9,088m<sup>2</sup> of property adjoining existing holdings for \$3.2m, primarily cash funded. The holding comprises a combination of offices, workshops and hardstand areas zoned for industrial/mixed business use. The property is currently partially leased.

## Business Segments

FFI operates multiple divisions within its three reporting segments:

- Smallgoods
- Investment Property
- Bakery



## **BAKERY**

### **Overview**

The bakery segment involves the processing, manufacture and sale of chocolate and confectionery, baker's fillings, cake decoration toppings and packaging under proprietary and third party brands, servicing customers across retail and industrial/wholesale. Approximately 80% of products are sold outside of W.A., made possible by discounted backload rates.

Manufacturing capabilities are vast and include:

1. Wet cooking process (bakery jams and fillings, caramels, ice-cream variegates / ribbons)
2. Chocolate panning (nuts, fruits and candy)
3. Sugar panning (nonpareils, candy coating of chocolate drops and nuts)
4. Extrusion (chocolate vermicelli, rainbow sprinkles, decorations and inclusions)
5. Chocolate manufacture (buttons, chips, flake, batons, blocks and speciality lines)
6. Candy manufacture/inclusions (hokey pokey, crème brulee, peppermint and nut brittles)
7. Barrier coating (ice-cream inclusions)
8. Dry roasting/toasting (nuts and muesli)
9. Dry blending to customer specifications
10. Popcorn manufacture

We estimate that revenue split of the bakery division to be:

- Chocolate and confectionery (62%), 45% retail and 55% wholesale/industrial supplied
- Baker's fillings and cake decorations (27%), mostly wholesale/industrial supplied
- Packing and blending (11%), mostly retail supplied

FFI does not provide intra-segment profit splits within the bakery division. We estimate this is relatively similar across product ranges as all markets are highly competitive.

### **Market Position**

FFI's niche food manufacturing is a small part of the much larger food industry. During FY15 the entire bakery division delivered \$22.94m of sales. To put this into perspective, the annual Australian grocery spend on ice-cream, sweet biscuits and chocolate is \$1.12b, \$537.5m and \$2.48b p.a. respectively (Nielsen 2014 State of the Industry Report).

Competitors include large national companies right down to niche suppliers, depending on the product offering, with the main competitor being Dollar Sweets. We note a considerable part of the bakery segment is driven by sales of compound chocolate, generally in retail labels. The Group produces ~70 tons of compound chocolate per week. We estimate FFI to be the second or third largest producer of compound chocolate in Australia behind Nestle and possibly Cadbury.

## **Strategy and Direction**

The Group adopts a two tiered sales approach: (1) direct sales targeting larger end user needs with collaborated efforts between food scientist departments; and (2) commission based food broking services. We are attracted to the customer loyalty the first approach creates.

FFI's has stated that innovation has become an imperative part of its business, providing new business and market share protection. In recent times, the growing trend has been to move Australian food manufacturing offshore. We believe FFI's flat sales growth throughout the past six years is reflective of this trend.

FFI has stated that it has allocated considerable resources to building market share in the Eastern States, however, is yet to experience meaningful growth. We see direct market penetration outside of product innovation as unlikely given the business operates with a very lean sales team. With a lone sales person wearing many hats operationally, there is a concern that they are stretched across many areas of the business. As a consequence, we find it difficult to conclude future sales growth will be outside of GDP growth. An argument exists that the movement towards healthy alternative snack foods will result in shrinking of the markets which FFI supply. We believe FFI's innovation should protect the Company against such consumer shifts, but we remain cautious given the Company's flat sales growth since 2010.

We expect the majority of bottom line growth in the business to come from manufacturing efficiencies. We understand that whilst re-engineering improvements were made on the chocolate line during FY15, electrical manufacturing breakdowns are still being experienced with the scope for efficiency improvements still evident. Following a period of considerable capital expenditure over the past two years it is likely management will take a slow and steady approach to capex. We do not expect any considerable improvements to margins outside of FY16 cost-out guidance.

## **SMALLGOODS**

### **Overview**

Smallgoods engages in the manufacture and wholesale of fresh sausages, bacon, and other processed meat products. Products are produced fresh "made to order" and distributed to regional and metro customers throughout WA. Approximately 90% of products are distributed to retailers, (butchers, IGA and other independents). The business operates under the Tradition Smallgoods brand and produces over 25,000 kg of sausages, bacon and processed meat product per week.

Surplus production capacity exists, with night shift not operational and weekend shifts only running in the lead up to Christmas. Average machinery age is approximately 4-5 years, with estimated life expectancy 20-25 years.

### **Market Position**

Tradition Smallgoods operates in the niche market of delivering high quality cooked smallgoods throughout WA. As a consequence of its geographical location and scale of operation it does not try to compete with the likes of Primo, George Weston Foods and Hans in the cooked mass market. According to the Nielsen 2014 State of the Industry Report, the Australian smallgoods market is ~\$2b p.a. We note of this Tradition Smallgoods makes up approximately \$7m p.a., a very small fraction of the market share.

## Strategy and Direction

We believe meaningful growth in this segment is likely to originate from industry consolidation of family owned WA based niche smallgoods manufacturers. Nielsen data from 2014 shows the smallgoods industry decreased 0.9% from pcp. At present we understand suitable competitors are not interested in consolidation. Therefore, much like the bakery segment it is difficult to put forward a growth case in smallgoods in excess of GDP growth.

## INVESTMENT PROPERTY

### Overview

The Company holds four investment properties, as well as the land and buildings from which the manufacturing business operates. The Company does not cross-charge rental between its operating business and property division. Therefore, earnings from this division are purely third party. The properties all adjoin head office site at 17 Knock Place, Jandakot. The site is well positioned close to the Kwinana Freeway providing easy access to Perth Metro (approx. 20 minutes by vehicle), Cockburn Town Centre and Cockburn Centre Train Station (Mandurah Line).

The below map depicts the entire property portfolio; split as follows:

- **Vacant land – serviced and subdivided (22,000 m2 approx)**
- **Vacant land – serviced but not subdivided (10,000 m2 approx)**
- **Developed and partially leased for ~\$100k p.a. (9,000 m2 approx)**
- **Veolia – fully developed and leased for ~\$750k p.a. (18,000 m2 approx)**
- **FFI – food manufacturing business (25,000 m2 approx)**





**Strategy and Direction**

FFI's strong balance sheet allows management to take a longer term view of its existing property holdings to increase shareholder returns. Management believes this can be achieved by way of realising value from fully developed areas; enhancing and realising value through development and lease potential; and holding for long term value increases from structural changes.

We expect the next catalyst for meaningful property value increases within the Group to be the Kwinana Freeway overpass on North Lake Road. This will deliver two outcomes: (1) remove traffic bottlenecks at Beeliar Drive improving traffic flow to Cockburn CBD and Perth metro; and (2) will result in the construction of Verde Drive ring route, encouraging additional economic development within the Cockburn Industrial Park and enhancing FFI property values. We understand Cockburn Council approval has been given for construction of Verde Road; however this will not commence until the State completes the North Lake Road overpass.

A joint venture between Cities of Armadale and Cockburn has been started to lobby for an alternative freeway interchange through to Armadale Road. This is currently in the consulting phase and is being heavily challenged by FFI. We believe this would intersect part of FFI's property. An outcome on this matter will not be known for approximately 6-12 months. The likely result will not involve land forfeiture by the Company.

Post construction of Verde Drive we see ample subdivision opportunities as well as interest in the surplus land holdings, and as a consequence expect additional value to be unlocked. Given the proposed freeway interchange is still in consultation/dispute stage, and funding has not been raised and or allocated, we do not expect the overpass to be built for at least 7-10 years, despite being earmarked for 2020-2022.

## Key Risks

### Quality Assurance

Operating in the highly regulated food manufacturing environment FFI is exposed to risks of product recalls exposing it to potential customer claims and loss of reputation. We note the Company's R&D Technologists manage the Group's quality control, and ensure it is compliant with food safety audits. We are not aware of any claims FFI's recent history. Whilst acknowledging this risk, we note high food regulation standards provide meaningful barriers to entry for new entrants.

### Cost of Manufacturing and Globalisation of Food Industry

Higher Australian manufacturing costs in comparison to overseas markets continues to be a risk to the Company. FFI mitigate this risk through niche market supply and maintaining strong quality control. Business innovation is encouraged by way of product development and cost cuts which ensure the Company is valued and cost competitive amongst customers.

### Commodity Risk

FFI is exposed to a number of input commodities, in particular: coco powder, sugar and vegetable fats. Company policy is to forward buy at levels where margins are workable for the business. The Company has stated it is not a commodity trader. This process is entirely managed by the Executive Director, Geoff Nicholson. We believe input commodities are forward bought at levels similar to FY15 and therefore would expect similar gross margins throughout FY16. Whilst we acknowledge the current informal forward buying policy allows FFI to be opportunistic, a risk does exist that commodities could be locked in at levels higher than competition resulting in a reduction in gross margins.

### Loss of Key Customers

FFI has three customers which contribute 21% of revenue. We understand that strong customer service and flexibility of operations have led to strong customer satisfaction. Whilst the risk is small, should FFI lose some of its larger customers without similar replacement, earnings and profitability could suffer.

### Valuation of Cockburn Property Market

FFI has surplus property holdings, some tenanted and some vacant land. All property is held in close proximity of Cockburn Central Town Centre and Cockburn Central Railway Station with easy access to Perth from Kwinana Freeway. Management has shown an appetite to unlock further value from existing holdings as well as acquire additional adjoining land. We note our valuation considers the underlying food business and market value of the property as separate parts and therefore a downturn in the Cockburn property market would subsequently impact our valuation of the Company.

### Trade Credit Risk

Sales are typically made on credit terms of 7-60 days. The Company manages its credit risk with procedure maintenance to mitigate bad debt risk, and as such has had ~0.1% of sales not collected over the past two years. We believe this to be a result of a strong trade credit policy as well as the long standing nature of the underlying customer base, and therefore whilst a trade credit risk exists, it is virtually negligible.

### Dependence on Key Personnel

FFI has a number of key management staff with substantial experience. As is the case with most small organisations when key people leave, valuable relationships and knowledge exit the business with them. We understand FFI has a culture of promoting internally, as evident by Brett Matthews, who commenced on the production line part-time, and 23 years later has progressed through the business to the position of Finance/Corporate Manager. Whilst we acknowledge internal talent have opportunities to progress, the fact remain, such examples are few and far between. We believe FFI has high exposure to key man risk, in particular, Rod Moonen, Robert Strong and Geoffrey Nicholson.

## Analysis of FY15 Financials

	FY14A	FY15A
* Total Revenue (m)	30.5	30.7
* Revenue Growth	(1.9%)	0.7%
* EBIT (m)	2.4	3.5
* NPAT (m)	1.7	2.4
* EPS (c)	18.4	25.5
* EPS growth	(47.6%)	38.3%
Ordinary Dividend (c)	17.5	19.0
Special Dividend (c)	25.0	0.0
Payout Ratio	117.4%	83.8%
* ROE	6.0%	8.1%

\* All numbers adjusted for revaluation on investment property and costs to upgrade chocolate manufacturing operations

FY15 Adj. NPAT increased 41% to \$2.4m, with revenue increasing 0.6% to \$30.7m. This resulted in Adj. ROE increasing 2.1% to 8.1% on pcp. The profit increase was primarily driven by an entire year of revenue from property leased to Veolia. We note the underlying manufacturing business sales decreased \$0.4m from pcp (1%) to \$29.9m, as a result of order timing.

Net cash contributed from operating activities was strong at \$3.6m, inline with reported EBITDA for the year. We note \$0.8m increase in operating cashflow was a result of positive working capital movements. Average debtor days continued to hover around 50 days. This was not surprising given customer mix did not materially change from pcp. As a result, net debt finished the year at \$0.5m, a reduction of \$1.6m from pcp, amongst a healthy dividend payout and one-off re-engineering costs for chocolate production.

Management declared fully franked dividends of 19 cents per share for FY15, a payout ratio of 84% on reported earnings. FFI's dividend reinvestment plan was operational for both interim and final FY15 dividends, with shares issued at \$3.43 and \$3.30 respectively. We expect the DRP to continue through FY16 and FY17, as management has (1) a conservative approach to debt; and (2) shown a desire to acquire adjoining property as well as unlock further value from existing dormant investment properties.

## Financial Forecasts

	FY14A	FY15A	FY16E	FY17E
* Total Revenue (m)	30.5	30.7	31.5	32.3
* Revenue Growth	(1.9%)	0.7%	2.8%	2.5%
* EBIT (m)	2.4	3.5	3.6	3.8
* NPAT (m)	1.7	2.4	2.5	2.6
* EPS (c)	18.4	25.5	24.4	24.9
* EPS growth	(47.6%)	38.3%	(4.3%)	2.0%
Ordinary Dividend (c)	17.5	19.0	20.0	20.0
Special Dividend (c)	25.0	0.0	0.0	0.0
Payout Ratio	117.4%	83.8%	82.0%	80.4%
* ROE	6.0%	8.1%	8.0%	8.0%

\* All numbers adjusted for revaluation on investment property and costs to upgrade chocolate manufacturing operations

### FY16

We estimate revenue to increase by 2.8% to \$31.5m, driven by economic growth and some incremental rental (\$0.1m) on the newly acquired investment property. We expect this to flow to Adj. NPAT and forecast a \$0.1m increase to \$2.5m. Management has demonstrated a healthy appetite for dividends throughout FY14 and FY15 and we expect this to continue over the next few years, forecasting fully franked dividends of 20 cents per share each year (82% and 80% payout ratios). We have forecast the DRP to continue throughout FY16 and FY17 (60% take-up, nil underwritten) as management banks funds for future land developments.

We estimate capex of \$0.6m p.a. for FY16 and FY17 as the business methodically upgrades machinery. Pending acquisition of a complementary business we do not expect capex outside of these levels. We forecast net debt to finish the year at approximately \$2.2m, an increase of \$1.7m from pcp mainly due to the October 2015 acquisition of further investment property.

### FY17

We estimate revenue to increase by 2.5% to \$32.3m, purely driven by economic growth. As a result, we expect ROI to plateau at approximately 8%. We note there is a possibility to unlock a further \$0.2m of rent from investment property acquired in FY16, although we have not forecast this into either year's projections.

We have not estimated any land revaluations throughout FY16 or FY17, and note the next catalyst for property revaluations will be development of North Lake Road Bridge and Verde Drive (sometime between 2018-2025), which opens the door to multiple subdivision opportunities and will increase interest in the land due to better traffic flows.

We forecast net debt to finish the year at approximately \$0.3m, a decrease of \$1.9m from pcp. If a DRP is not offered in FY17 we expect net debt to finish the year at \$1.6m.

## Valuation / Price Target

The table below compares FFI with listed Australian based food manufacturers which distribute into both the retail and wholesale/industrial markets.

	Mkt Cap (AU\$m)	EV/EBIT (x)		Dividend Yield		EBIT Margins	
		FY16E	FY17E	FY16E	FY17E	FY16E	FY17E
Bega Cheese Ltd	844	19.3	29.1	1.7%	2.0%	3.9%	2.4%
Capilano Honey Ltd	174	12.0	10.5	2.6%	3.0%	10.7%	11.2%
Freedom Food Ltd	570	33.6	25.8	1.3%	1.6%	17.0%	20.0%
Patties Foods Ltd	155	8.8	8.1	5.9%	6.8%	9.5%	9.8%
Tassal Group Limited	657	10.9	9.6	4.2%	4.5%	15.2%	15.7%
FFI Holdings Ltd	34	9.9	8.9	5.9%	5.9%	11.8%	12.1%
Average (Including FFI)		15.8	15.3	3.6%	3.9%	11.3%	11.9%

We believe a valuation using an EBIT multiple best captures the operating businesses. Whilst the pool of comparable companies is small, a 9-10x multiple is appropriate for a niche food manufacturing business of FFI's size with a strong balance sheet.

FFI holds significant investment property and other excess land which it does not utilise. Thus we have incorporated this into our valuation (net of debt) in addition to our multiple. We have not undertaken any formal property valuations; however have conviction on values listed in the FY15 Annual Report based on the October 2015 property acquisition. Our property valuation (net of tax) is based on FY16e (post depreciation and October 2015 acquired property).

We have removed third party rent collected and estimated rental for the manufacturing property from our valuation below. We have also added back estimated property owner costs not payable by a commercial lessee as these costs would not be incurred by FFI if the property were rented from a third party.

We arrive at a price target of \$3.38 (post tax on investment properties). Excluding the 20% liquidity discount, our price target would have been \$4.23.

	FY16 EBIT	Multiple		Valuation		Per Share	
		Low	High	Low	High	Low	High
Group EBIT	3.6	9.0	10.0	32.6	36.2	3.18	3.53
Less: Market Rent	(1.6)	9.0	10.0	(14.8)	(16.4)	(1.44)	(1.60)
Add: Property Owner Costs	0.3	9.0	10.0	2.7	3.0	0.26	0.29
Total Enterprise Value				20.5	22.8	2.00	2.22
Less: Net Debt				(2.2)	(2.2)	(0.21)	(0.21)
Add: Market Value of L&B				28.0	28.0	2.73	2.73
Less: Tax on L&B				(4.1)	(4.1)	(0.40)	(0.40)
<b>Equity Value Per Share</b>				42.2	44.5	4.12	4.34
Liquidity Discount						20%	20%
<b>Value Per Share</b>						3.30	3.47

## Board of Directors/Management

### Executive Chairman

#### Rodney Moonen

Mr Moonen was appointed as a Director of the company in 1988, subsequently to Chairman and Company Secretary in 1990. Mr Moonen has over 40 years' experience in management and finance. Mr Moonen has a Bachelor of Business Studies from Curtin University.

### Executive Director

#### Geoffrey Nicholson

Mr Nicholson was appointed as a Director and General Manager of the company in 1986. Mr Nicholson has over 38 years' experience in the food processing industry. Mr Nicholson is hands on and involved in many facets of the business including R&D, forward commodity buying, direct selling and maintaining customer relationships.

### Non Executive Director

#### Robert Fraser

Mr Fraser was appointed as a Director of the company in 2011. Mr Fraser has over 25 years' experience in investment banking and currently is the Sydney based Managing Director of TC Corporate Pty Ltd, the corporate advisory division of Taylor Collison Limited stockbrokers, of which he is also a Director and principal. He is also a licensed business broker and real estate agent. Mr Fraser holds current directorships with ARB Corporation Limited, Gowing Bros. Limited and Magellan Financial Group Limited. Mr Fraser has a Bachelor of Economic and Hons in Law from Sydney University.

### Other Key Personnel

#### Brett Matthews

Mr Matthews commenced with the company in 1992. Mr Matthews started in the factory, quickly moving into an office role, and progressing in the company to Finance/Corporate Manager. Mr Matthews is responsible for the operational, financial and strategic management of the food businesses and property portfolios. Mr Matthews has 27 years' experience in accounting and financial management. Mr Matthews has a Bachelor of Commerce.

#### Robert Strong

Mr Strong commenced with Tradition Smallgoods Pty Ltd in 1988 and has been Managing Director since 1992. Mr Strong has over 40 years' experience in the meat and smallgoods industry. Mr Strong is a European trained and trade accredited Master Butcher, meat processor and smallgoods maker.

As at 30 June 2015 the Board and key management personnel held 3,785,738 shares in the Company (39.1%), ensuring management and shareholder goals are closely aligned.

## Major Shareholders

As at 1 September 2015, FFI's 20 largest shareholders were:

Shareholders	Shares Held	% of issued shares
Pearlwood Holdings Pty Ltd	1,906,004	19.7%
Evelin Investments Pty Ltd	751,024	7.8%
Kenneth John Beer	728,123	7.5%
Salter Point Investments Pty Ltd	596,579	6.2%
Warr Nominees Pty Ltd	473,832	4.9%
Geoffrey Wayne Nicholson	363,331	3.8%
JP Morgan Nom Aust	305,417	3.2%
Nairana Pty Limited	264,979	2.7%
Samuel Gordon Simpson	246,360	2.6%
BB Holdings Pty Ltd	224,734	2.3%
Rodney Graham Moonen	204,144	2.1%
Brett Matthews	193,320	2.0%
Love, Francis Alan	160,364	1.7%
Keiser Investments Pty Ltd	140,581	1.5%
Nereid Pty Ltd	96,297	1.0%
Tracy Fraser	93,073	1.0%
Julie Nicholson	87,999	0.9%
Hans Herbert Moonen	80,076	0.8%
G.G. Panizza Pty Ltd	79,988	0.8%
David Fitzhardinge	75,533	0.8%

As at 1 September 2015 there were 9,672,585 shares on issue. The top 20 shareholders own 73.1% of FFI's total issued shares.

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