Oldtown Berhad

Fantastic homegrown brand

OUTPERFORM

Price: RM1.25
Target Price: RM1.46

Oldtown Berhad (Oldtown), the largest Oriental style café chain in Malaysia, is a true local success story in the domestic F&B industry. But this is just likely the beginning of its fame and fortune in our view. Oldtown is now planning an aggressive expansion overseas in China, Korea and Vietnam, replicating on its successful business model locally of operating coffee chain café and the distribution of instant coffee and tea beverages. This model is in our view highly scalable as it its food outlets and beverages suit the Asian and Chinese taste and with the right management and marketing push, Oldtown could well morph into the big-time league – similar to the likes of the big Western coffee chains or fast-food outlets in these markets, which were unknown when they first started but are consumed everyday now by the hungry and growing populations of these emerging Asian markets.

While it's far-fetched to imagine Oldtown being in exactly the same league now, we believe that even a small success in these markets could see its earnings jumping in the next few years given its much smaller base compared to these players. We particularly like Oldtown for its China growth story here. The company plans to open 20-40 new food outlets per annum here for a start (which is highly scalable if demand catches on), as well as expanding and centralising its beverage manufacturing arms to jump on the bandwagon of the booming China's F&B growth. In addition, Oldtown is also planning to venture into Vietnam and South Korea for its FMCG division this year as well. All these would be on top of its already steady and growing local revenue and earnings.

The stock in our view is a good bet on this story and we are initiating coverage on Oldtown with a fair value of RM1.46 based on 12x PER over its FY12 EPS of 12.2 sen. The 12x PER is justifiable as compared to the 5-year industry average PER of 15x given its lower market capitalisation at the moment. But if its China and other overseas markets expansion above catches on fast, Oldtown's growth could well be in another league. OUTPERFORM.

The largest oriental café chain in Malaysia, yet still expanding aggressively. Oldtown with 196 outlets is currently the biggest local Oriental style F&B café chain player, leaving its closest competitor, Pappa Rich's 58 outlets in the dust (in terms of menu). The company is listed in the Malaysia Book of Records of having the largest "Kopitiam" chain in Malaysia. Oldtown is also ranked second among operator of café outlets based on total number of outlets in Malaysia behind confectionary café player, Secret Recipe. We expect the overall revenue of its café chain operation to register 16%-9% growth for FY11-12 on the back of 21 and 25 new outlets respectively, which is conservatively lower compared to the management's vision of 20-40 new outlets locally.

When growth comes calling fast. Fast-moving consumer goods (FMCG) segment should be another strong growth driver for Oldtown as the company is looking at an approximately 20% growth rate per annum here. 20% of the contribution comes from exports, and thus we foresee that there is much more room to grow here. Oldtown has recently appointed more FMCG distributors in China improve its market shares and sales there as management sees lucrative demand from the China market. Given its 3x capacity expansion plan for the FMCG segment, we believe this segment (which involves the manufacturing and distribution of beverages) can easily generate double digits growth of 25%-20% per annum for FY11-12.

A defensive and growth play soon as well? OldTown adopts a policy of distributing a minimum of 50% of its annual profit as cash dividend payout. Based on our FY11-FY12 net profit estimates of RM36.8m-RM40.2m, we expect the company to distribute a GDPS of about 5.6 sen-6.1 sen, which translates into an attractive dividend yield of 4.5%-4.9%. While we have conservatively only estimate a growth of around 12% per annum in net profits for Oldtown in the next two years for now, if its overseas expansion is successful and catches up fast, we would certainly need to relook at our numbers again.

STOCK DATA

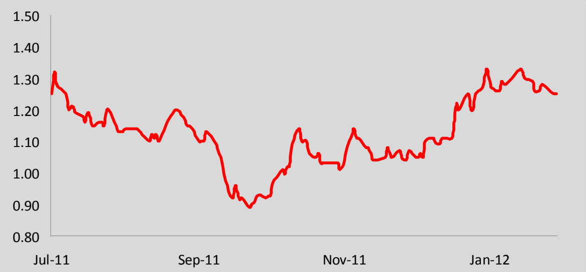
Bloomberg Ticker	OTB MK Equity	*YTD price*	4.2%
Market Cap	412.5	*YTD KLCI*	2.3%
Issued shares	330.0	*Beta*	N.A.
52-week range (H)	1.40		
52-week range (L)	0.89	***Major Shareholders***	
3-mth avg daily vol:	1,070,295	OLD TOWN	59.1%
Free Float	36.9%	LEE SIEW HENG	2.4%
Altman Z-score	N.A.	TAN SAY YAP	1.6%

AT A GLANCE	***OldTown Bhd***
Target Price (RM):	***1.46***
Valuation:	*12x PER*
Current Price (RM):	1.25
Report Reason:	*Initiating Coverage*
Action:	***OUTPERFORM***
Reason:	-
Basis of call:	*Organic growth*
Catalyst:	*Capacity expansion, spreading global footprint, 50% dividend policy*

FYE31Dec RMm	***2010A***	***2011F***	***2012F***	***2013F***
Turnover	255.1	304.0	342.6	394.4
Net Profit (NP)	**31.5**	**36.8**	**40.2**	**51.3**
Consensus (NP)		***35.2***	***39.2***	
Earnings Revision:		-	-	

Earnings Revision Rationale: -

SHARE PRICE CHART



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Investment merits

Café

Rapid expansion in the domestic and regional F&B markets. OldTown is expected to breach its 200-outlet milestone this year. The company will continue to open café outlets and expand the coverage locally and in the overseas countries, targeting up to 300 outlets by 2015. The ambitious management aggressively targets to open up to 40 outlets per year in Malaysia and other countries. An inspiring bigger expansion master plan for the group includes opening 20-30 outlets per annum in Malaysia, 3-4 outlets in Singapore annually, 75 outlets in Indonesia over the next 10 years and 172 outlets in China over the same period as well. We believe the lower target is definitely viable as the company on average has opened 30 outlets per annum since 2007 (when it has only 75 outlets). Furthermore, the company has opened 21 new outlets domestically and regionally in 2011 so far. As for the bigger master plan, if demand do catches on its coffee chain cafes and beverages manufacturing and sales, Oldtown's growth would then be in an entirely different league.

Going forward for now, we expect the majority of the new outlets will fall under the franchising and licensing model and thus, we are looking at a 27%-13% and 31%-12% YoY jump in the revenue of the franchising related fees, and product sales to franchisees, respectively in FY11 and FY12. This should contribute approximately 24% and 25% to the overall revenue of the company for FY11 and FY12 respectively. Meanwhile, we also expect the overall revenue of the café chain operation to register growths of 16%-9% for FY11-12 on the back of 21 and 25 new outlets respectively, which is conservatively lower compared to management's vision of 20-40 new outlets locally.

Network of Café Outlets (as at 31 Dec 2011)

	Fully owned	Partially owned	Franchised	Licensed	Total
Malaysia	76	11	96	0	183
Singapore	3	5	0	0	8
Indonesia	0	2	0	2	4
China	N.A.	N.A.	N.A.	1*	1
Total	**79**	**18**	**96**	**3**	**196**

**The China franchisee is holding a Master Franchise License for Guangdong and Macau Province.*

Source: The Company

Estimated No. of Café Outlets

	FY2010A	FY2011E	FY2012E	FY2013E
No. of outlets at the beginning of the year	145	175	196	221
Increase in No. of outlets	30	21	25	25
No. of outlets at the end of the year	**175**	**196**	**221**	**246**

Source: The Company, Kenanga Research

Going for the "big one" - China. Oldtown has recently penetrated into the China market by launching its first outlet in Guangzhou (the third largest city in China and the largest in southern China) last Nov through its newly engaged licensing partner. The company is choosing strategic locations to catch the attention of different group of consumers here. The first outlet was opened in a subway station while the second outlet will be opened soon in the central business district of Guangzhou to target the working class by 1Q2012. We believe that it is still early to judge the profitability of the China's operation at this juncture and a 6 to 12 months gestation period will be needed to observe its progress. However, management commented that the response so far for the first outlet was good and it has an ambitious vision of opening 172 outlets in China within a 10-year period. On the other hand, the company is also looking forward to set up a centralised kitchen in China this year together with its partner. We reckon this will actually reduce the cost of food production by cutting down on the shipping cost plus streamlining the process of distributing the food materials.

According to *"Roast",* a Portland magazine dedicated to the success and growth of the specialty coffee roaster, two facts about China as a country make it especially enticing for coffee businesses. Firstly, it's the world's most densely inhabited country, with a population of more than 1.3b. Secondly, China has traditionally been a tea-drinking country, but its younger generations are switching slowly to coffee. Granted, coffee consumption in China is still very low, with estimates showing that the per capita consumption is just about 3 cups per year, compared with the average per capita consumption in the United States of 3.5 cups per day. Since the coffee industry is still in its infancy in China, the coffee market in China, the country also being world's largest consumer market, has nowhere to go but up. China's appetite for coffee is growing and the annual increase of coffee consumption in China is around 15%, which is much higher than the world's average. Chinese per capita coffee consumption has also been on the rise for the last 15 years. The rapid growth of coffee shop chains, along with the concurrent development of the Western food and beverage scene, is the main driver of Chinese coffee consumption. As such, we actually think that Oldtown's expansion plan here looks promising and we will continue to monitor developments here closely given that success in populous China will likely register strong growths for Oldtown.

Green light for F&B HALAL status by 2012. Riding on the fact that Malaysia is ranked as the top halal-friendly holiday destination for 2012 among the 10 member states of the Organisation of Islamic Cooperation, Oldtown is eyeing to capture more market shares of the existing 60% Muslim customers in Malaysia despite its cafés' primarily Chinese customers at the moment. OldTown's F&B processing centres has obtained HALAL status from the Perak state's Islamic Religious Dept and its F&B café chain outlets are also expected to get the status from Department of Islamic Development Malaysia (JAKIM), the most prominent HALAL certifier. The company is thus likely to be a full participant in the local HALAL market by the end of this year. OldTown also actively participates in various advertising and promotional campaigns to boost its sales among the Muslim community. The group will utilise more allocation this year to advertise on TV3 & Astro Ria to target and penetrate mainly into the Muslim market. In fact, in 2011, encouraging growth was observed in its coffee products sale in supermarkets which are located in the high-Muslim populated areas e.g. Shah Alam, Bangi and Putra Height.

Fast Moving Consumer Goods (FMCG)

A far-flung sales network. Fast-moving consumer goods (FMCG) segment should be another strong growth driver for Oldtown as the company is looking at an approximately 20% growth rate per annum here. We understand that only 20% of the contribution comes from exports, and thus we foresee that there is much more room to grow here. As such, Oldtown has recently appointed more FMCG distributors in China including in the Shanghai and Beijing's regions to expand its market share. We believe that this area looks promising for the group and management also sees lucrative demand from the China market and is seeking more potential distributors in the different provinces to improve its market shares and sales together with brand building its name through the operation of café chains.

Oldtown has already have an extensive network for the distribution of retail packs of coffee and tea in Malaysia as well as in the overseas markets including USA, Canada, Taiwan, Indonesia, Brunei, Thailand, Philippines, China, United Kingdom and Australia. The company has appointed 18 distributors, which distribute to over 7,768 retail outlets nationwide in Malaysia, 752 retail outlets in Singapore and 2,870 retail outlets in Hong Kong. The marketing is mainly supported by an Asia's leading market expansion services provider based in Malaysia to handle the regions of Malaysia and Singapore.

Storming into new market. In addition, the company is also planning to penetrate into the South Korea and Vietnam markets through the services provider's exposure in these two regions in FY12. The management is not expecting bulky order from these countries in the short term, but will still focus on building its brand name in these countries first. According to Korea International Trade Association (KITA), Korea imported coffees worth USD508m for the first 10 months of 2011, which already outperformed its total import value of USD307m in 2010. The increased was due mainly to the greater demand for diverse brands and high-end coffee products. Dongsuh Foods Corporation, the largest coffee retailer in Korea, has surveyed a study population of 34.7m Koreans and found that on average, Korean adults drank an average of 670 cups of coffee per year or an average of 1.83 cups per day. Demand of coffee is thus higher in South Korea than in Malaysia. Given the changing generation profile as the main driver for growing coffee consumptions especially in the developing countries together with the company's extensive distribution network, we expect Oldtown will continue to grab even more market shares in its various expansion regions, which should translate into a greater organic growth for it in the near future.

Ongoing expansion of FMCG. Oldtown's wholly-owned subsidiary, White Café S/B is constructing a new factory (Phase 1) in Ipoh, which includes a 2.5-storey factory bulding, a 1-storey warehouse, a 2-storey canteen and training centre, a 3-storey administration building and 2 units of security guardhouse. The construction is expected to kick off on 1 Feb and is expected to be completed towards the end of the third quarter, which is 8 months from now. This project was mentioned earlier in its initial public offering (IPO) prospectus last year, and it is actually part of its initial expansion plan. The company is actually looking forward to increase its current manufacturing operation capacity by 5.0x and to centralise its manufacturing operations in Ipoh for logistic efficiency. The first phase of this expansion, which will be ready by this year-end, will increase the production of its instant coffee mix and instant milk tea mix by 3.0x from their current total capacity of 7.9k kg. We believe that by the end of this year, the utilisation of Oldtown's current capacity may hit close to 100% (currently 82%). Hence, the new capacity above could be up just in time at the beginning of 2013 to cater for the greater local and overseas demand for its products. For FY13, we foresee the utilisation rate of the new total capacity to be around 45% with approximately 10%-20% of the new capacity being utilised and we are looking at a utilisation rate of 60% by FY15 if not earlier. We believe the new demand will come strongly from China as the company has recently just appointed two different distributors based in Beijing and Shanghai respectively.

Given this comprehensive plan that will pave the way for greater growths in its FMCG segment, we believe that we believe this segment (which involves the manufacturing and distribution of beverages) can easily generate double digits growth of 25%-20% per annum for FY11-12. In addition, we also think that the key products to boost the revenue will be predominantly coming from its home brand's coffee beverages and instant milk tea mix.

Production / Operating Capabilities and Output

Products	2010			9M 2011		
	Actual Production ('000 kg)	Capacity[1] ('000 kg)	Utilisation Rate	Actual Production ('000 kg)	Capacity ('000kg)	Utilisation Rate
Instant coffee mix and instant milk tea mix	5,455[2]	7,920	69%	4,900	5,940	82%
Roasted coffee powder	373[3]	1,248	30%	340	936	36%
Food Processing	1,398[4]	6,114	23%	1,191	4,585	26%
Bakery and confectionery processing	811[2]	1,339	61%	628	1,004	63%

(1) Capacity is calculated based on 24 hours per day, six days per week.
(2) Based on 1.5 eight-hour shifts per day and six days per week.
(3) Based on 1 eight-hour shift per day and six days per week.
(4) Based on 1 nine-hour shift per day and 6 days per week.

Source: The Company

The group's strengths

No.1 white coffee producer in Malaysia. In the domestic white coffee mix industry, OldTown is the No.1 white coffee producer controlling nearly 40% of the market share. In 2010, OldTown has a market share of approximately 10% of the local production of coffee (ground and instant) in the FMCG sector and also qualifies as one of the heavyweight players in the Malaysia's coffee industry. OldTown has the ability to dictate the pricing of its products by being the market leader in the white coffee market. The average per capita consumption for coffee is about 250 cups per year in Malaysia, which is still very far behind Western Europe countries and US which have an average of 500-600 cups per year. This means our coffee market still has lots of room for growth.

One of the market leaders in HK and Singapore. According to Nielsen research report in 2010, Oldtown is ranked No. 2 with a 23.8% market share behind leading global brand Nescafe, which controls 33% of the highly competitive Hong Kong coffee mix market. Oldtown's over 10 years of hard work in Singapore meanwhile has finally paid off by it ending up in the top 3 coffee mix players in the Republic.

Experienced and dedicated management team. Oldtown's management team is led by professionals and founders who have more than 20 years' experience in the industry. The Group Managing Director has more than 20 years experience in the manufacturing and retailing industries, of which more than 10 years of that is in the coffee beverage industry. OldTown co-founders, Mr. Goh Ching Mun and Mr. Tan Say Yap, are both veterans with more than 20 years and 10 years experience in the coffee manufacturing industry respectively and they are also still involved actively in the business. We are of the view that the experienced management team is more than capable and passionate to anchor OldTown towards more success in the future.

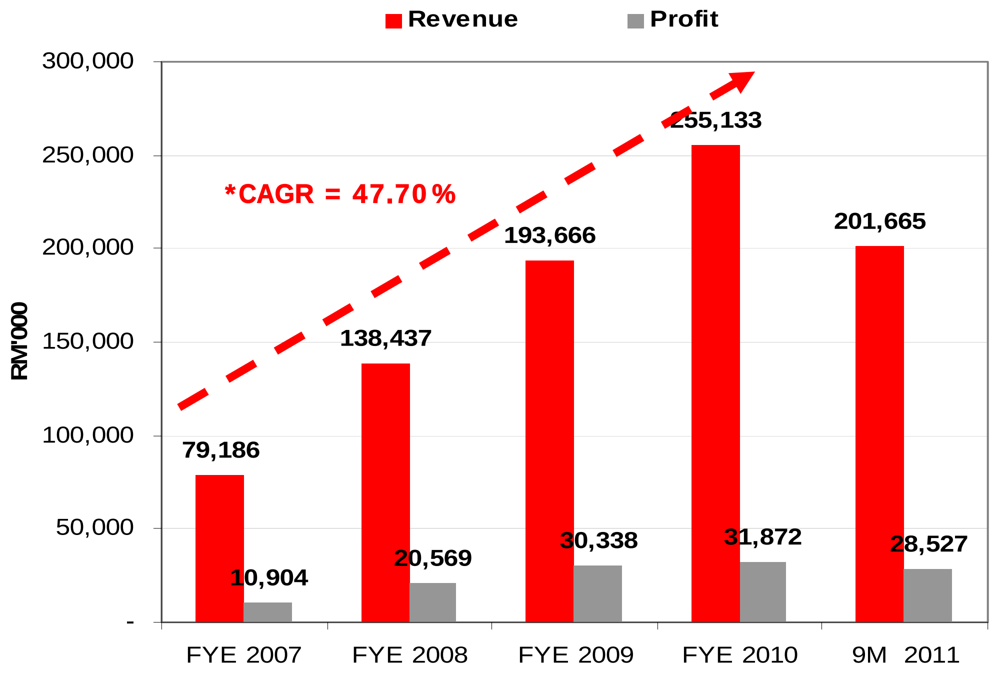
Strong commitment to shareholders. The company has adopted a dividend policy of returning at least 50% of its annual net income to shareholders every year as gross dividend. Based on our FY11-FY12 net profit estimate of RM36.8m-RM40.2m, we expect the company to distribute a GDPS of about 5.6 sen-6.1 sen, which translates into an attractive dividend yield of 4.5%-4.9%.

Financial Highlights

Close to a CAGR of 50%. Given the strong CAGR of revenue registered by both the operation of the café chain and manufacturing of beverages segments (51% and 42% respectively), the group has delivered an exceptionally strong 3-year CAGR of 48% in its total revenue. The significant growth was mainly attributable to the aggressive growth in the number of its café outlets from 75 cafes at the end of 2007 to 175 café outlets at the end of 2010 as well as its extensive retail distribution chain in Malaysia and overseas. The cost of operations meanwhile has been well managed within a ratio of 62%-68% of sales even during the recession in 2008 and 2009. The group's gross profit margins thus are around

33%-38% of sales with the net profits margins at around 12%-16%. We note also that the group was able to deliver a 3-year CAGR of 44% for its bottom line as compared to a 3-year CAGR of 48% for its top line, reflecting improvement in its cost structure.

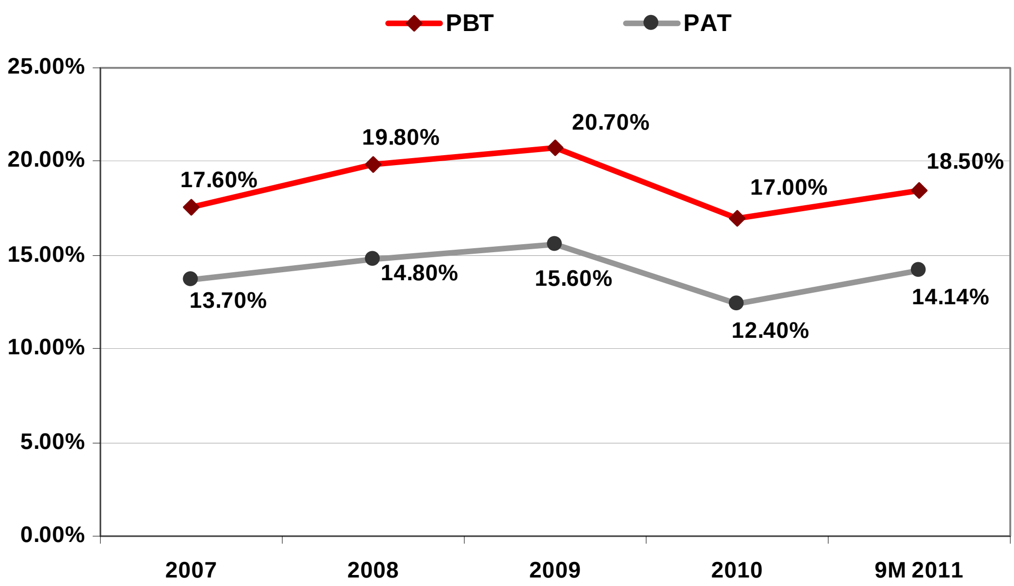
Total Net Profit & Total Revenue



*CAGR: Compounded annual growth rate (%)

Source: The Company, Kenanga Research *excludes fair value gains

Total Net Profit vs Total Revenue



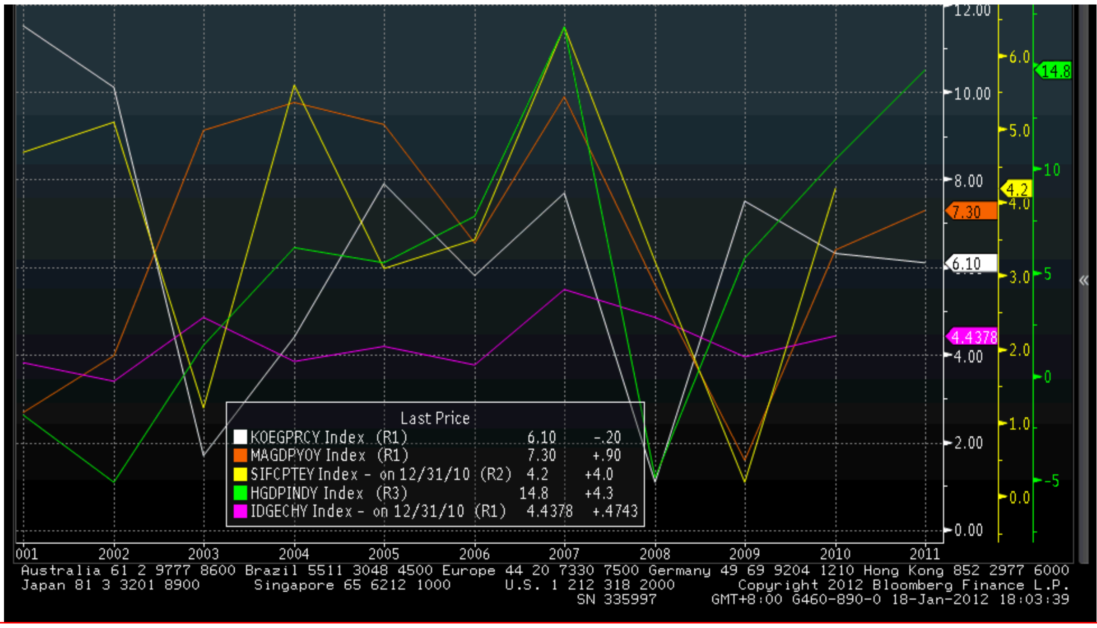
Source: The Company, Kenanga Research

In 9M11, Oldtown recorded RM201.7m in revenue while its 9M11 net profit of RM28.5m was already 90% of the 2010 full year net profit of RM31.5m, thanks to a one-off gain on disposal of investment in associated companies of RM5.1m. We expect the group to turn in another RM8.5m profit for the last quarter of 2011, closing the financial year with a non-core net profit of RM36.8m or a core net profit of RM31.9m. Although we are conservatively looking at a relatively flat core net profit growth for Oldtown in FY11 compared with FY10, we however expect Oldtown to register higher growths of 27%-28% for its FY12-13 core net profits. Our estimates are mainly driven by the double digits strong growth of the revenue contribution from the manufacturing of beverages segment by 20% for FY12-13 and the strong revenue growth of the operations of café chain by 9%-12% for the same period. Coupled with the continuing improvement in cost control and increasing benefits from economies of scale as it expands, we expect Oldtown to register core net profits of RM40.4m and RM51.6m for FY12-FY13 respectively, representing YoY growth of 27%-28%.

Financial-wise, the group has zero gearing with a net cash position of RM66.2m. Even after its recent spending of RM36.7m on the construction of a new factory, the group will still be in a net cash position with RM29.4m cash to run the business with a reasonable working capital of approximately RM15m-RM25m.

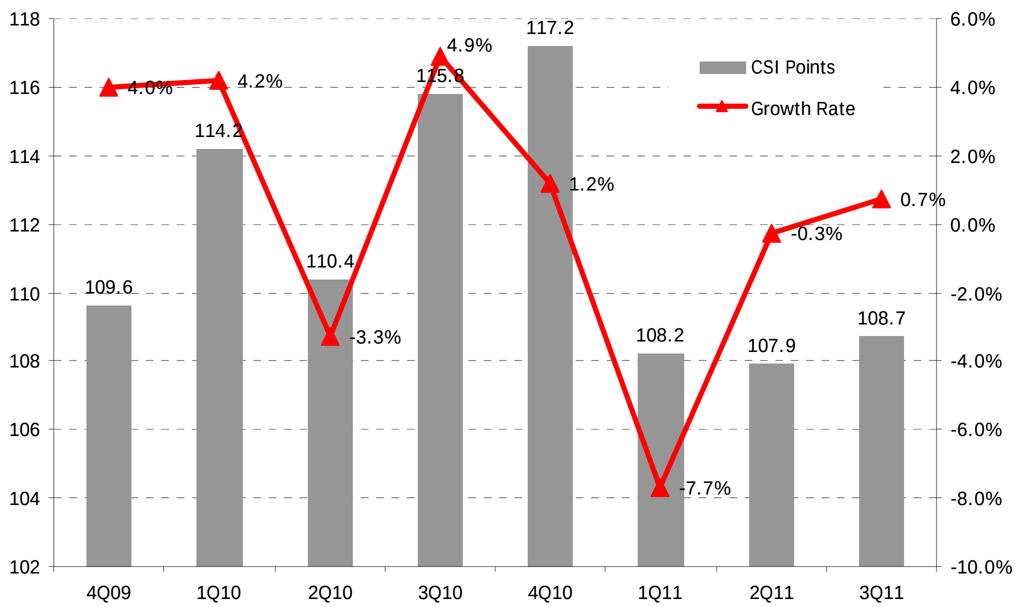
Industry Outlook

Private Consumption Growth in Various Countries



Source: Bloomberg, Kenanga Research

Consumer Sentiment Index (CSI) in Malaysia



Source: Malaysian Institute of Economic Research

Performance of the F&B Industry is mainly dependent on the general economic environment, consumer confidence and spending pattern in a country. Malaysia is expected to experience continuing growth and our in-house economist estimates GDP growth for 2011 and 2012 to be at 5.1% and 5.2% respectively.

The level of consumer confidence of the economy will also affect consumers' spending pattern. In the third quarter of 2011, the CSI grew 0.7% to 108.7 points from 107.9 points in the second quarter of 2011.This was attributable to improvement in the current and expected financial and employment expectations.

On another hand, the growth of the accommodation and restaurant industry will provide sustainability and growth opportunities for food and beverages operator focusing on Café Outlets. According to Vital Factor Consulting Sdn Bhd, a private forecaster, the accommodation and restaurant industry in Malaysia grew at an average annual rate of 6.3% between 2006 and 2010 and is expected to grow by 5.2% in 2011. Hence, this favours Oldtown as it is the largest oriental café outlets in Malaysia and is well supported by an experienced management team. Coupled with the better real GDP in its operating countries, the company is likely to continue to grow strongly in this region.

The Malaysian government is targeting a 9.4% contribution from the franchise industry to the country's gross domestic product (GDP) by 2020 from 2.2% in 2011 through the implementation of the National Franchise Development Master Plan 2012-2016. This will spur the growth of franchise businesses like Oldtown with enhanced competitiveness and efficient human capital development in the business.

The market size for restaurants and cafes in Malaysia was valued at RM23.1 billion in 2010 and Oldtown only captured not more than 1% of it. Nielsen Malaysia estimated that the value of Malaysia's instant coffee mix market is at around RM600m. The outlook for the instant coffee mix products is still optimistic and Malaysia's instant coffee mix market has been enjoying double digits growth in recent years. This shows that Oldtown still has enormous potential to grow its business and capture a bigger market share.

In recent years, the government has started to cut subsidies for sugar and fuel and also introduced new electricity tariff rates, which saw the F&B industry facing increasing cost pressures. Nonetheless, the easing prices of raw materials such as coffee, sugar and creamers (which are the major costs for Oldtown's beverages products) following the retracement of global commodities prices from their highs last year will help the company to record a better profit margin this year.

As highlighted earlier, Oldtown is one of the largest local oriental style café chain players and beverages manufacturers in Malaysia and with its aggressive F&B café chain outlets rollout and capacity expansion supported by the implementation of the government's Economic Transformation Program (ETP) and National Franchise Development Master Plan 2012-2016, Oldtown is expected to benefit from a continuing resilient F&B industry and favourable consumer environment.

Risks

Changes in consumer preference and market perception. The F&B business is largely dependent on the goodwill of consumers and market's receptiveness associated with the various brands. Consumer preference and market perception are expected to change from time to time and Oldtown needs to constantly adapt to these changes. Malaysia is the only country in the world that has more than 100 types of coffee mix product in the market due to the various drinking habits of its consumers and stiff competition in the industry. However, Oldtown's established brand name with good market reputation plus aggressive advertising and promotion activities that appeals to its target group will ensure that it continues to have a loyal base of customers.

Quality of food products and services. Inconsistency in the quality of food products may dissatisfy customers and make them switch to other choices in the market. Shortage of local labours and difficulties of finding the right people to take up the front-liners jobs in the cafes were among the main hurdles faced by the F&B industry in recent years. This shortage of manpower problem has minimal impact to Oldtown as its products and services are 'quick serve' which require a low-skill requirement for its staffs. Oldtown has also not been affected by inconsistent food quality as all its foods are prepared by the central food processing centres.

Volatile raw materials prices. Costs of its main raw materials, such as coffee beans, sugar and creamer are affected by movement in the global commodity prices. Change in climatic conditions and governmental regulations will change the supply of the raw materials leading to fluctuation in costs of raw materials. Any interruption in raw materials sourcing will then lead to the disruption of operation and profitability erosion. Thus, Oldtown's earnings will be affected if the raw material prices go up. However, Oldtown's suppliers have proven to be reliable in the past and Oldtown has not encountered any problems in this matter.

Difficulties in maintaining existing outlets and securing new outlets. Some of Oldtown outlets are rented and the owners have the right to review and change the term and conditions of the rental agreement from time to time. Oldtown may face an increase in the rental fees or a refusal for tenancy extension. This will adversely impact its operations and profitability. New premises at strategic locations are also in scarcity and hard to secure plus they may usually required many months of rental payment upfront. This will stretch the group's cash flow in an aggressive expansion scenario. However, all rental increases have already been forecasted and mutually agreed upon for Oldtown café outlets. Furthermore, the proportion of franchised outlets (where rental is fully borne by the franchisees) will increase gradually in the future, which will reduce the company's rental cost.

Risk associated with market expansion outside of Malaysia. Oldtown is venturing into new markets outside Malaysia. Although market diversification will provide growth potentials and reduce Oldtown's dependence on the domestic market, this will however expose Oldtown to the various F&B regulations in foreign jurisdictions. In addition, given its dependence on third party distributors and joint venture partners or franchisees to expand the business, Oldtown may face financial constraints due to possible higher costs incurred following any over-expansion plans.

Valuation

Favourable industry trend. Of late, we sense that the consumer F&B sector could be undergoing a rerating process with the offers to take both KFC (Malaysia) (KFC) and QSR Brands (QSR) private by a few parties. It was reported that Massive Equity S/B (MESB), which is a JV company between Johor Corp. and CVC Capital Partners (51:49 basis) had made bids for KFC and QSR at RM4.00 and RM6.80 per share respectively. With the privatisation of KFC and QSR, there will not be that many remaining quick service restaurants stocks on Bursa Malaysia and hence, Oldtown could benefit from this from more investors' interest in its stock.

Oldtown is presently trading at PERs of 11.2x and 12.2x for FY11 and FY12 respectively. We value Oldtown at RM1.46 based on a PER of 12x on its FY12 EPS of 12.2 sen. We believe the 12x PER is justifiable as compared to the 5-year industry average PER of 15x, representing a 20% discount due to Oldtown's lower market capitalisation. Coupled with a dividend policy of 50% payout, we expect gross dividends per share of 5.6 sen and 6.1 sen for FY11-FY12, translating into an attractive GDY of 4.5% and 4.9% respectively. This will see the stock offering a total return of 22% on the back of a 17% potential capital appreciation. As such, we are initiating coverage on Oldtown with an Outperform recommendation.

Valuation

PER	12.0x
FY 12 EPS	12.2 sen
Target Price	**RM 1.46**
Potential upside	+17%

Source: Kenanga Research

Peer comparison

NAME	Price (RM)	Mkt Cap (Local Currency'mn)	Historical PER (x)	Est. Current Year PER (x)	Est. Next Year PER (x)	Est. Div. Yld.	Hist. PBV (x)	Hist. ROE	Consensus TP (RM)
QSR BRANDS BHD	6.45	1,957.11	17.76	15.85	14.02	2.3	1.99	14.3	6.48
KFC HOLDINGS (MALAYSIA) BHD	3.82	3,030.28	19.32	19.20	16.90	1.8	2.86	17.6	3.95
OLDTOWN BHD	1.26	415.80	13.12	11.45	10.50	4.5	2.21	16.2	1.55
BERJAYA FOOD BHD	1.08	153.56	17.69	n.a.	n.a.	n.a.	3.01	20.9	n.a.

Source: Kenanga Research/ Bloomberg

Earnings Estimates

FYE 31Dec (RMm)	2009A	2010A	2011F	2012F	2013F
Turnover	193.7	255.1	304.0	342.6	394.4
EBIT	40.5	45.3	46.9	57.0	72.7
Pretax profit	40.2	43.4	50.7	55.3	70.7
Net Profit	**30.3**	**31.5**	**36.8**	**40.2**	**51.3**
EBIT margin (%)	20.9	17.8	15.4	16.7	18.4
Pretax margin(%)	20.7	17.0	16.7	16.2	17.9
Net profit margin (%)	15.7	12.3	12.1	11.7	13.0
Effective tax rate(%)	24.0	26.6	26.6	26.6	26.6
Growth ratios					
Turnover (%)	39.9	31.7	19.2	12.7	15.1
EBIT (%)	43.3	11.9	3.5	21.6	27.4
Pretax profit (%)	46.5	8.0	16.9	9.1	27.8
Net profit (%)	47.4	3.9	16.9	9.1	27.8
ROE (%)	N.A.	16.2	15.5	16.2	16.3
ROA (%)	N.A.	11.9	11.0	12.0	12.2
Net Gearing (x)	N.A.	net cash	net cash	net cash	net cash
Per share data					
EPS (sen)	9.2	9.5	11.2	12.2	15.6
EPS growth (%)	47.4	3.9	16.9	9.1	27.8
PER (x)	13.6	13.0	11.1	10.2	8.0
GDPS (sen)	0.0	0.0	5.6	6.1	7.8
Div. Yield (%)	0.0%	0.0%	4.5%	4.9%	6.2%
NTA/share (RM)	N.A.	0.5	0.6	0.6	0.6

Source: Kenanga Research

Income Statement

FY Ended 31 Dec	2009	2010	2011E	2012E	2013E
Turnover	193.7	255.1	304.0	342.6	394.4
EBIT	40.5	45.3	46.9	57.0	72.7
Net Interest Income/Expense	(1.0)	(1.5)	(1.2)	(1.2)	(1.3)
Income Before Taxation	**40.2**	**43.4**	**50.7**	**55.3**	**70.7**
Taxation	(9.6)	(11.5)	(13.5)	(14.7)	(18.8)
Net Income	**30.4**	**31.7**	**37.0**	**40.4**	**51.6**

Source: Kenanga Research

Cash Flow Statement

FY Ended 31 Dec	2010	2011E	2012E	2013E
Cash Flow From Operations	42.2	31.5	58.3	51.6
Cash Flow From Investment	(86.2)	37.5	(36.7)	(30.0)
Cash Flow From Financing	59.9	(17.4)	(19.0)	(24.5)
Net Cash Flow	15.9	51.7	2.7	(2.9)
Opening Cash	9.1	25.0	76.7	79.3
Ending Cash	25.0	76.7	79.3	76.4

Source: Kenanga Research

Balance Sheet

FY Ended 31 Dec	2010	2011E	2012E	2013E
Assets				
+ Cash & Near Cash Items	30.6	76.7	79.3	76.4
+ Accounts Receivable	36.6	38.1	40.4	43.5
+ Inventories	12.9	16.5	13.4	17.5
+ Others	7.6	18.9	6.7	7.1
Total Current Assets	**87.7**	**150.2**	**139.8**	**144.5**
+ PPE	96.6	59.1	95.8	125.8
+ Others	70.9	77.9	77.9	77.9
Total Long-Term Assets	**167.5**	**137.0**	**173.7**	**203.7**
Total Assets	**255.2**	**287.2**	**313.5**	**348.2**
Liabilities				
+ Accounts Payable	39.0	33.3	41.1	35.7
+ Short-Term Borrowings	5.9	2.6	2.6	2.6
+ Others	4.4	6.6	6.7	6.7
Total Current Liabilities	**49.3**	**42.5**	**50.4**	**45.0**
+ Long-Term Borrowings	10.4	17.3	17.3	37.3
+ Others	7.3	7.2	7.2	7.2
Total Long-Term Liabilities	**17.7**	**24.5**	**24.5**	**44.5**
Total Liabilities	**67.0**	**67.0**	**74.9**	**89.5**
+ Share Capital	330.0	330.0	330.0	330.0
+ Share Premium	11.9	12.3	12.3	12.3
+ Reserves	(222.7)	(222.6)	(222.7)	(222.7)
+ Retained Earnings	68.8	100.2	118.7	138.7
Total Shareholders' Equity	**188.0**	**219.9**	**238.3**	**258.4**
Total Liabilities & Equity	**255.2**	**287.2**	**313.5**	**348.2**

Source: Kenanga Research

Appendix

Company Background

Oldtown was founded by Mr. Goh Ching Mun and Mr. Tan Say Yap in 1999 and has successfully commercialised their own-blend instant 3-in-1 coffee mix under the 'OLDTOWN' brand name for the retail sector. With the expertise in Coffee mix, the company subsequently introduced their formulated blend of 3-in-1 instant milk tea and roasted coffee powder for the food services sector and marketed under the 'NANYANG' brand. Under the leadership of Mr. Lee Siew Heng, Group Managing Director, the company continued to expand the local retail distributions and penetrate the export market to countries such as Singapore, Japan, China, Thailand, Philippines.

In 2005, the company recorded another milestone by expended its business vertically into the food services sector by opening a chain of café outlets based on the traditional Ipoh coffee shop setting and ambience under the 'OLDTOWN WHITE COFFEE' brand name. Since then, they successfully expanded to 182 café outlets in Malaysia and strengthened their footprints by having 9, 4 and 1 café outlets in Singapore, Indonesia and China respectively.

Management Team

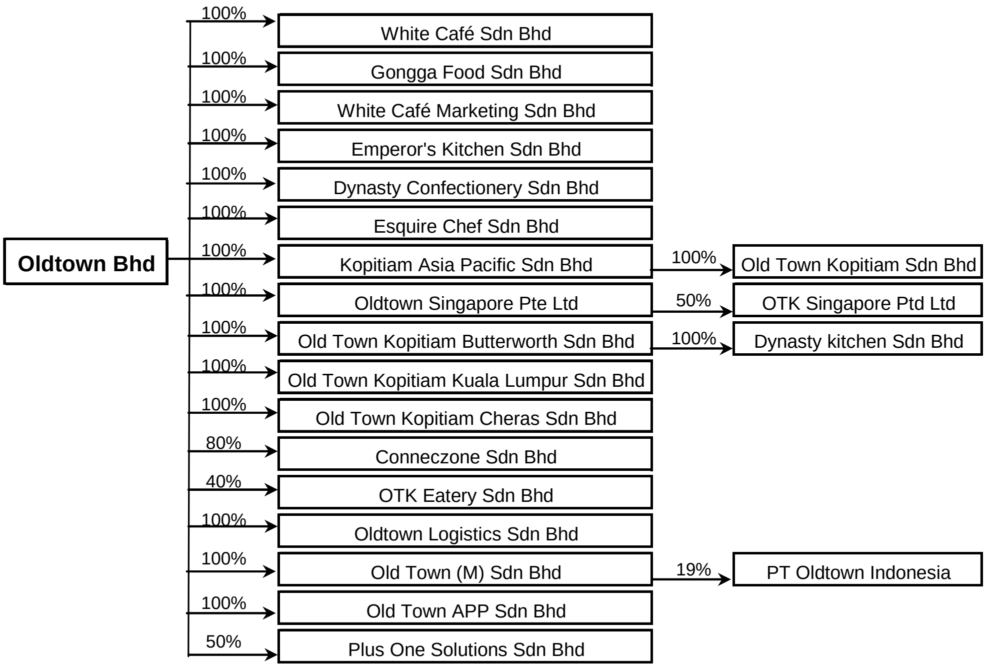
Key Management team / Board of Directors

Name	Designation / Function
Datuk Dr. Ahmad Tasir Bin Lope Pihie	Independent Non-Executive Chairman
Lee Siew Heng	Group Managing Director
Goh Ching Mun	Executive Director & Product Research and Development Director
Tan Say Yap	Executive Director & Corporate Relation Director
Clarence D'Silva A/L Leon D'Silva	Executive Director & COO for F&B Sector
Chuah Seong Meng	Executive Director & COO for FMCG Sector
Chin Lai Yoong	Non-Independent Non-Executive Director
Mark Wing Kong	Independent Non-Executive Director
Dr. Leong Chik Weng	Independent Non-Executive Director

Source: The Company

Corporate Structure

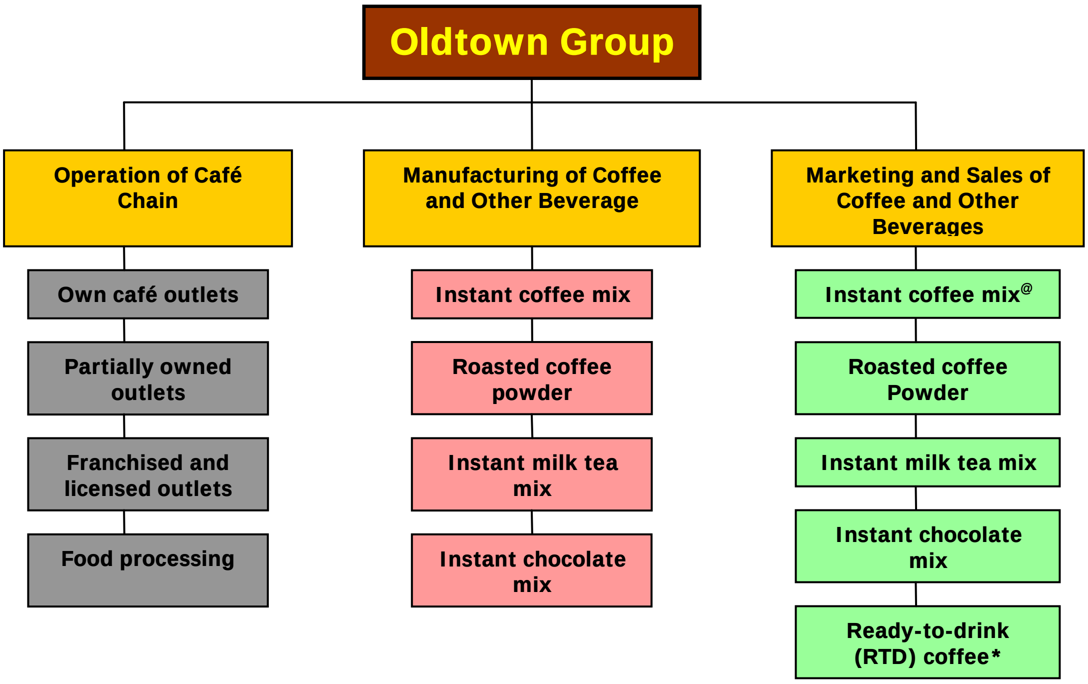
Group Structure



Source: The Company

Business Activities

Business Activities



Notes: -

@ Also includes instant bottled coffee which represented a very small proportion of total revenue for FYE2010

* RTD coffee started in 2009

Source: The Company

Oldtown is principally involved in 3 divisions, which are the operation of chain café, manufacturing of coffee and other beverage and marketing and sales of coffee and other beverages. Drilling into profitable arms, Oldtown's revenue is generally contributed from the operation of chain café (65%) and the manufacturing of coffee and other beverage (35%).

Food and Beverages (F&B) Business

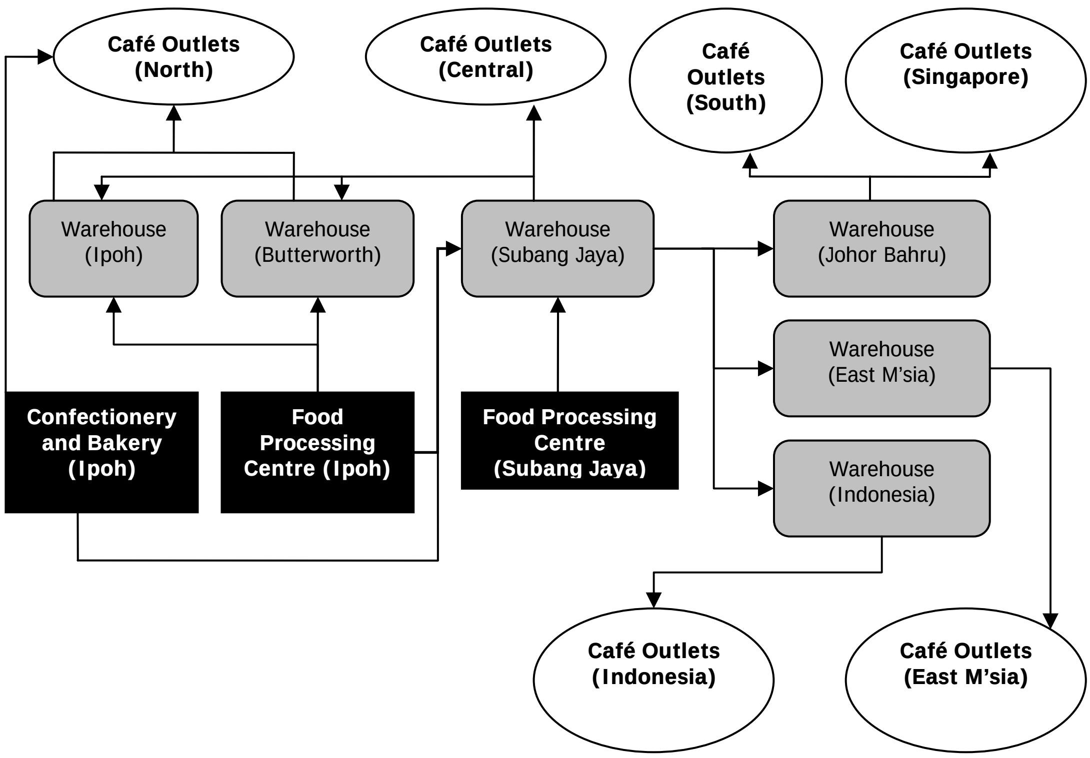
- **Operation of Café Chain**

  Oldtown currently has 196 café outlets in Malaysia, Singapore, Indonesia and China in which approximately 50% of the café outlets are either fully owned or partially owned and operate under Oldtown owned management while the remaining 50% are either franchised or licensed outlets. In terms of revenue contribution, it is primarily derived from the operation of the fully owned cafes, sales of products to franchisees and franchising fees, which amounted to 40%, 20% and 5% of total group revenue, respectively, in FY10.

  To provide customers with value-added services, the company has introduced conceptualised outlets such as the Signature café and the Eat & Bank synergy concept outlet together with CIMB. This has heightened the brand awareness and outreach to another level for better customer experience, service and satisfaction. The 5 **'OLDTOWN WHITE COFFEE'** ***Signature*** café outlets that the company has provided a greater interior design, dedicated cook, a more extensive food menu and commands on average a premium of approximately 19% on its food and beverages price while the eat & bank outlet offers customers the convenience of performing their banking transactions and enjoying the experience with Oldtown.

  3 centralised food processing centres operated by its subsidiaries, Dynasty Confectionery, Esquire Chef and Emperor's Kitchen are responsible to support the café outlets by processing of all the ingredients for the outlet's menu. The menu focuses mainly on serving the local fare that is traditionally available at coffee shops. These include half boiled eggs, specialty rice, homemade toasted bread and buns, noodles, sandwiches and others, which target at all ages of customers.

Processing Flows of Distribution Activities



Source: The Company

Fast Moving Consumer Goods (FMCG) Business

- **Manufacturing of Coffee and Other Beverages**

Oldtown has **2 manufacturing arms namely White Café and Gongga Food**, involving in manufacturing of its own brand name 'OLDTOWN' coffee and tea beverages, including instant coffee mix, instant milk tea mix, instant chocolate mix and roasted coffee powder (under the 'NAN YANG' brand name) respectively.

OldTown has expanded its range of coffee products to include **freeze dried and spray dried instant bottled coffee** by sub-contracting the production and packaging of the products to an overseas manufacturer in Poland due to incompetence of local technology to pack the products.

In addition, the company has entered into RTD (Ready-to-Drink) beverage market, where the product is canned and the ingredient is based on its own formulation and packed under 'OLDTOWN' brand name in Dec 2009. Its RTD coffee is primarily distributed via supermarket, hypermarket, petro kiosks and convenience stores.

For the FY10, the manufacture of coffee and other beverages for the retail sector contributed 34.9% of the Oldtown's total revenue, breaking down into Coffee beverages including instant coffee mix, roasted coffee powder and RTD coffee (31%), instant milk tea mix (3.6%) and instant chocolate mix (0.2%).

Manufacturing of coffee and other beverages

Instant Coffee and Tea Beverages	OLDTOWN 3 in 1 Classic White Coffee
	OLDTOWN 3 in 1 Natural Cane Sugar White Coffee
	OLDTOWN 3 in 1 Hazelnut White Coffee
	OLDTOWN 3 in 1 Ice Cold White Coffee
	OLDTOWN 2 in 1 White Coffee & Creamer
	OLDTOWN 3 in 1 White Milk Tea
Roasted Coffee Powder	NAN YANG White Coffee 'O'
	NANYANG 2 in 1 White Coffee 'O'

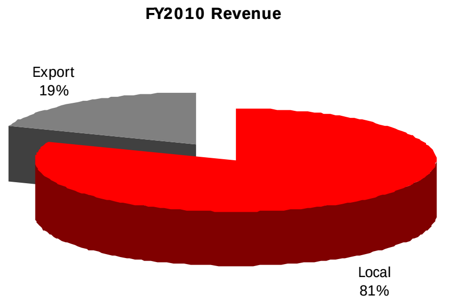
Source: The Company

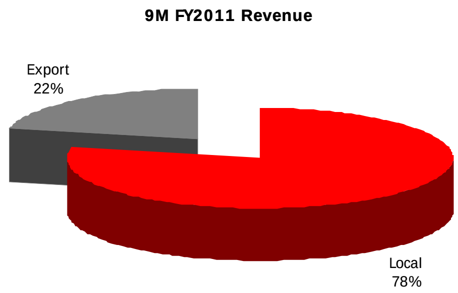
- **Marketing and Sales of Coffee and Other Beverages**

  OldTown's subsidiary, White Café Marketing, is responsible for the retail of its instant coffee and tea beverages via a strong distribution network in Malaysian as well as overseas. Additionally, its 'OLDTOWN' beverages were sold in approximately 7,768 retail outlets in Malaysia, approximately 752 retails outlets in Singapore and approximately 2,870 retail outlets in Hong Kong.

  OldTown exports its beverage products to other foreign countries, including USA, Canada, Taiwan, Indonesia, Brunei, Thailand, Philippines, China, United Kingdom, New Zealand Australia for the FYE 2011.

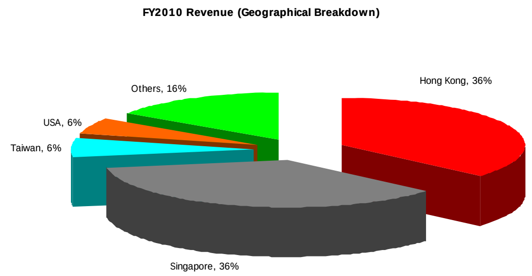
Principal Markets for Products and Services (Local vs Export)

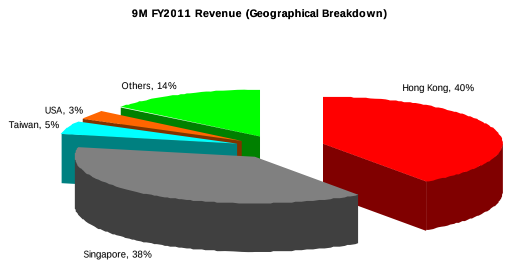




Source: The Company, Kenanga Research

Principal Markets for Products and Services (by countries)





Source: The Company, Kenanga Research

Stock Ratings are defined as follows:

Stock Recommendations

OUTPERFORM : A particular stock's Expected Total Return is MORE than 10%
(An approximation to the 5-year annualised Total Return of FBMKLCI of 10.2%)
MARKET PERFORM : A particular stock's Expected Total Return is WITHIN the range of 3% to 10%
UNDERPERFORM : A particular stock's Expected Total Return is LESS than 3%
(An approximation to the 12-month Fixed Deposit Rate of 3.15% as a proxy to Risk-Free Rate)

Sector Recommendations***

OVERWEIGHT : A particular stock's Expected Total Return is MORE than 10%
(An approximation to the 5-year annualised Total Return of FBMKLCI of 10.2%)
NEUTRAL : A particular stock's Expected Total Return is WITHIN the range of 3% to 10%.
UNDERWEIGHT : A particular stock's Expected Total Return is LESS than 3%
(An approximation to the 12-month Fixed Deposit Rate of 3.15% as a proxy to Risk-Free Rate)

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

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