

MANAGEMENT DISCUSSION & ANALYSIS

Chief Executive Officer

Lim Yew Hoe

Dear Shareholders,

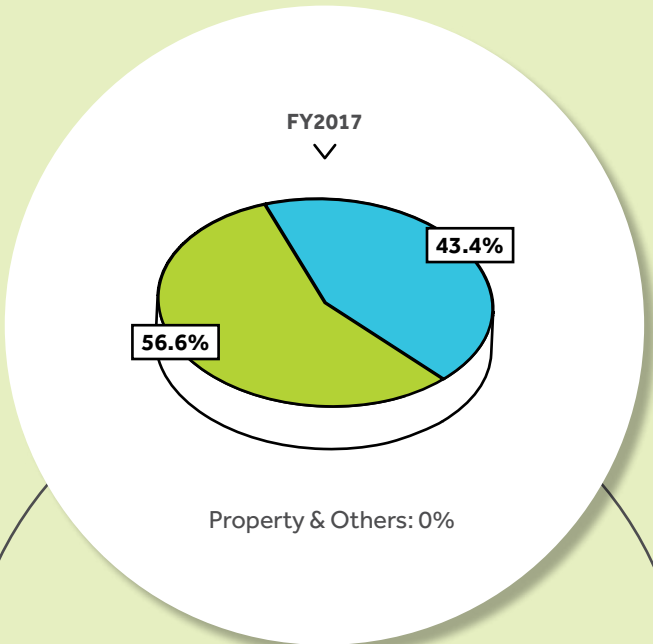
The financial year ended 30 September 2017 shows yet again the discipline and decisiveness of Fraser & Neave Holdings Bhd (F&NHB or the Group) in taking comprehensive actions to ensure long-term sustainability of performance amidst prolonged challenging circumstances. Once again, the Group's resilience, built on our geographical and product diversity as well as our 134-year heritage, has enabled us to make considerable progress towards our vision to be the No. 1 total beverage company in the region by 2020.

FY2017 was defined by various macro-economic factors, intense price competition and higher commodity costs, which combined to create a challenging environment for the Group. This is particularly so for Food & Beverages Malaysia domestic operations. Nevertheless, it is what we have done amidst these difficult circumstances that counts more for the future. Specifically, this financial year marked a major milestone for the Group as we completed one of the biggest business transformation programmes in F&N's history.

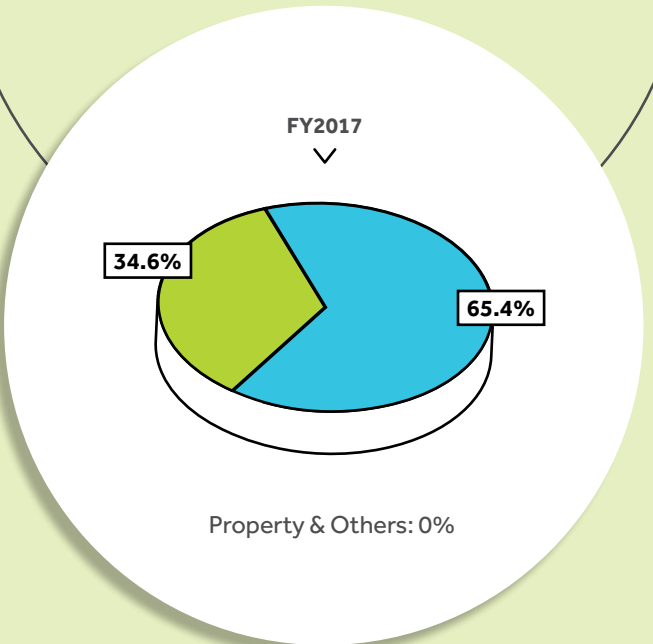


Group Revenue

Contribution by Business Segment (%)



■ F&B Malaysia ■ F&B Thailand



Group Operating Profit

Contribution by Business Segment (%)

The Group now has three independent growth pillars – Food & Beverages Malaysia Domestic (F&B Malaysia Domestic), Food & Beverages Thailand (F&B Thailand) and Exports – each with its own long-term strategies and short-term priorities to support a sustainable F&NHB. While F&B Malaysia Domestic focused on completing its transformation, and capturing synergistic values from the various cost optimisation and efficiency improvement initiatives, F&B Thailand expanded its coverage and created stronger consumer allegiance through innovative applications and brand building. In the meantime, our Exports team redoubled its efforts to grow sales in the international market.

Effective trade and marketing execution by F&B Thailand resulted in continued top and bottom-line growth, despite general market contraction of 5 per cent. The Exports business, meanwhile, achieved strong double-digit growth for the third consecutive year. Strong performances by these two business pillars cushioned the impact of short-term costs resulting from F&B Malaysia Domestic's transformation, and even enabled the Group to absorb most of the commodity price increases seen during the year.

More significantly, as a result of our transformation, we are today a leaner and more effective organisation. Essentially, we have strengthened F&NHB at a fundamental level to be more competitive with greater capacity to meet external challenges.



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FINANCIAL & SEGMENTAL REVIEW

Soft consumer sentiment and intense competition, especially in Malaysia, led to 1.6 per cent lower revenue for the Group at RM 4.10 billion from RM 4.17 billion last year.

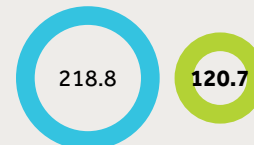
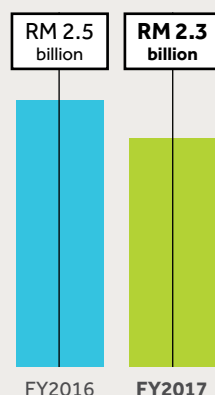
Operationally, we were most impacted by rising costs of commodities, especially that of sugar in Malaysia. Resin and tinplate prices also increased, though by smaller amounts. As such, the Group recorded a 20.4 per cent contraction in operating profit to RM 345.1 million. However, excluding the cost of restructuring and other one-off items, operating profit was marginally lower, from RM 406.6 million in FY2016 to RM 397.8 million, thanks to more prudent control on non-commodity-related costs and Group wide efficiency improvements.

Segmentally, F&B Malaysia (Combined Domestic and Exports) saw an 8.2 per cent decline in revenue in FY2017 to RM 2.3 billion. This was not unexpected as we made a conscious "Blue Ocean" decision to stay away from value destruction price discounts in the face of intense price competition and soft consumer sentiment, which was particularly pronounced during the festive seasons when sales were subdued compared to previous years. Instead, we remain focused on completing our transformation programme, unwavering in our drive to build long-term sustainability.

Corresponding to lower sales, F&B Malaysia's operating profit declined by 44.8 per cent to RM 120.7 million. Excluding one-off items such as restructuring cost, the decrease in operating profit narrowed to 21.7 per cent from RM 216.5 million to RM 169.6 million. Profit erosion due to high input costs was offset by lower discounts, lower advertising and promotional spending, as well as lower overheads.

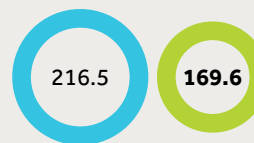
F&B Malaysia

REVENUE



FY2016 FY2017

OPERATING PROFIT (RM million)



FY2016 FY2017

OPERATING PROFIT (EXCLUDING ONE-OFF ITEMS) (RM million)

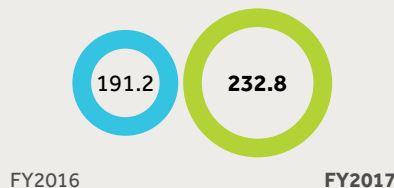
F&B Thailand

REVENUE



FY2016 FY2017

OPERATING PROFIT (RM million)



FY2016 FY2017

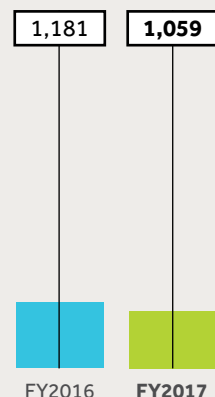
OPERATING PROFIT (EXCLUDING ONE-OFF ITEMS) (RM million)



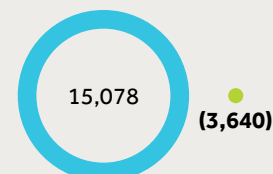
FY2016 FY2017

Property & Others

REVENUE (RM '000)

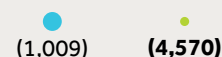


FY2016 FY2017



FY2016 FY2017

OPERATING PROFIT (RM '000)



FY2016 FY2017

OPERATING PROFIT (EXCLUDING ONE-OFF ITEMS) (RM '000)

Consumer spending was also soft in Thailand amidst a sluggish economic landscape exacerbated by the passing of King Bhumibol Adulyadej in October 2016. Adding to this, rural consumers, especially in the north, were affected by severe drought in the first half of the year.

Nevertheless, F&B Thailand registered an 8.7 per cent increase in revenue to RM 1.8 billion. This was mainly contributed by double-digit growth in exports to Indochina, the successful launch of two new BEAR BRAND milk products and an innovative squeezable TEAPOT sweetened condensed milk tube, aided by favourable Thai Baht - Ringgit exchange rate.

F&B Thailand's operating profit rose 14.3 per cent to RM 228.0 million from RM 199.5 million in FY2016. Excluding one-off items, operating profit grew by 21.8 per cent to RM 232.8 million.



>2,500 key activities
re-organised to improve
overall functional efficiency



Process & product innovation
ideas from employees
**deliver cost savings or cost
avoidance of RM 10 million
per annum**

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"Operationally, we were most impacted by rising costs of commodities, especially that of sugar in Malaysia."

OPERATIONS REVIEW

Improving Cost Efficiencies

During the year, we further enhanced the Group's efficiency and effectiveness via structural changes to our operations in Malaysia to streamline and simplify processes while optimising space and resources. More than 2,500 key processes were re-organised to improve overall functional efficiency and effectiveness. This has allowed for significant reduction in manpower requirement. Savings in overhead costs and improved efficiency in our process and product innovations have delivered sustainable financial benefits of more than RM 40 million per year.

Employees were encouraged to find ways to improve the way we do things through process and product innovation. At the "Excel as One" and "Winning as One" conventions, which we have been organising for the last three and ten years in Malaysia and Thailand respectively, various teams presented ideas they had converted into action to enhance our productivity, cost savings and/or product quality. This year, the 40 participating teams presented innovations that either improve productivity, deliver cost savings or cost avoidance to the tune of RM 10 million per annum.

One of the innovations in F&B Thailand received the Diamond Thailand Kaizen Award from the Technology Promotion Association (Thailand-Japan) for the best employee-driven productivity enhancement project in the country.



For more details about these innovations, please read our Sustainability Report.

Supporting employee innovation, we invest continually in the latest technologies to enhance our operational efficiencies. This is reflected in our substantial capital expenditure outlay, based on the Smart Capex principle. Aside from capability and capacity expansion, we seek new capex projects that will also enhance our cost efficiency through economies of scale, in-sourcing production and shortening our route to the different markets we serve.

Technology was a major component of our transformation programme and will continue to be a key enabler to enhance efficiencies in our system and processes. Today, we are leveraging on data analytics to predict market demand more accurately, and adjust our production volume accordingly. This has enabled us to bring down our inventory days significantly, saving us millions of ringgit a year.



Extracting Value from Route-to-Market Synergies

While continuing to deepen and widen our market penetration, we have transformed our route-to-market in Malaysia via a harmonisation programme. From having different sets of distributors to manage our dairy or soft drink products in the past, we now have a unified team of distributors that distribute the entire portfolio. Greater operational and route efficiencies from this exercise are expected to result in significant increase in sales along with greater volume of trade for some of our distributors.

To ensure a seamless transition for the more than 80,000 outlets that we serve nationwide, we worked very closely with our distributors at every step of this harmonisation journey, ensuring their readiness to manage greater logistics and warehousing needs, as well as larger sales teams. The exercise has greatly benefitted our retailers in terms of ease of doing business. With the harmonisation, they can place their orders for all F&N products with just one distributor, reducing their paperwork while enhancing their resource management.

In Thailand, the team increased its distribution network with the engagement of three new distributors in the south and north-east of the country as well as Bangkok. This brings its total number of distributors to 21 covering 135,000 outlets nationwide.

F&B Thailand also achieved enhanced visibility through the engagement of more hawkers nationwide. Using a comprehensive database of hawkers developed in-house, our distributors now service 40,000 hawkers, branded with TEAPOT and CARNATION® merchandise. Similar efforts to gain the loyalty of restaurants and food chains are ongoing.



Brand Performance

Despite cautious consumer spending and intensified competition, F&B Malaysia remained steadfast in our marketing and branding initiatives across a wide platform to offer consumers the right products at the right occasions. 100PLUS, OISHI, F&N SEASONS and F&N NutriSoy maintained leading positions in their respective categories in Malaysia while we reinforced our undisputed leadership in the condensed and evaporated milk segment with our stable of dairy products, namely F&N, Gold Coin, TEAPOT, CARNATION®, Cap Junjung® and IDEAL®.

The year was particularly exciting for 100PLUS, which gained exceptional mileage from being the Official Isotonic Beverage of the 29th SEA Games. The brand was entered into the Malaysia Book of Records for having the country's Biggest Dome Structure and the Biggest Can Replica (of a 100PLUS can).

We also signed a deal with McDonald's that saw 100PLUS being offered at all its 261 fast-food outlets nationwide. This partnership, which brings 100PLUS to more than 160 million McDonald's customers a year, is a positive step in positioning the isotonic beverage as a refreshing and healthier beverage for everyone.



Improved ease of doing business for our retailers with one harmonised team of distributors for our entire product portfolio



TEAPOT doubled market share in sweetened beverage creamer category



Export to halal core markets (Middle East & North Africa) grew >30%

In Thailand, BEAR BRAND and CARNATION® maintained their No. 1 positions in their respective categories through effective marketing and trade activities. CARNATION® was bolstered by the launch of the 140ml cans catering primarily to home users. Within three months of the launch, the small cans had gained 3 per cent share of the market. TEAPOT, meanwhile, managed to double its sweetened beverage creamer market share with the introduction of the squeezable tube. F&B Thailand also grew 13 per cent in Cambodia and Laos with a successful TEAPOT marketing campaign which increased its coverage to 12,000 hawkers.

Always a Healthier Choice

As a responsible corporate citizen, we place much emphasis on developing products that are good for health. This has seen us work constantly to reduce the sugar content of our drinks while adding vitamins and minerals to boost their nutritional value.

During the year, we further reduced the sugar index in our portfolio, which is now 24 per cent lower compared to FY2007, and expanded our healthier product range with four new products – 100PLUS ACTIVE and F&N NutriSoy Fresh in Malaysia; and BEAR BRAND Sterilised Milk Hi Folate and BEAR BRAND Gold Goji Berry in Thailand.

100PLUS ACTIVE is non-carbonated, catering to those who engage actively in sports and find it easier to quench their thirst with a non-carbonated isotonic drink. F&N NutriSoy Fresh, our pasteurised fresh soya milk is high in calcium containing all the goodness of nine essential amino acids. BEAR BRAND Sterilised Milk Hi Folate, fortified with high folate and iron content enhances blood circulation, while BEAR BRAND Gold Goji Berry is enriched with vitamin A for better eyesight.

We are proud to share that four of our products - 100PLUS, 100PLUS ACTIVE, FARMHOUSE Fresh and F&N Magnolia Lo-Fat Hi-Cal Milk – have been awarded the Healthier Choice logo in Malaysia. The endorsement was introduced by the Ministry of Health (MoH) in April 2017 to help consumers make healthier purchasing and dietary decisions.

In delivering our promise of "Pure Enjoyment, Pure Goodness", we aim to increase the number of healthier products in our portfolio and target to offer a healthier option for every beverage category we are in by 2020.

EXPORTS

We are growing Exports into our third business pillar, with an enlarged team focused on understanding our target markets and catering specifically to customers' discerning needs. From concentrating on ASEAN and Greater China, we have made early progress into two halal core markets – the Middle East and North Africa – where our halal certification added further leverage. Export volume to these markets grew by more than 30 per cent in FY2017.

Condensed milk continued to dominate the Exports business, with sales enhanced by differentiated packaging sizes catering to the specific needs of a diverse customer base, from individual consumers to industrial users. In FY2017, export of dairy products from Malaysia grew by 26 per cent. Meanwhile, we have established a pipeline to supply 100PLUS and F&N SEASONS to Ghana, Pakistan, Iran, Saudi Arabia and Japan.

Our Exports team is providing added value to our customers by working with them on developing new and innovative product applications. The intention is to develop long-term partnerships and establish F&N and TEAPOT as strong export brands. We have already established TEAPOT with partners in China and Mexico.

Overall, we increased our export markets to 55 countries, adding Angola, Bahrain, India, Iraq, Mexico and Yemen to the list. On current form, exports from Malaysia should surpass its target of RM 500 million sales ahead of the 2020 deadline. This will be supported by increased production capacity and the establishment of export regional offices which will strengthen our route-to-market capabilities as well as our understanding of the local market.

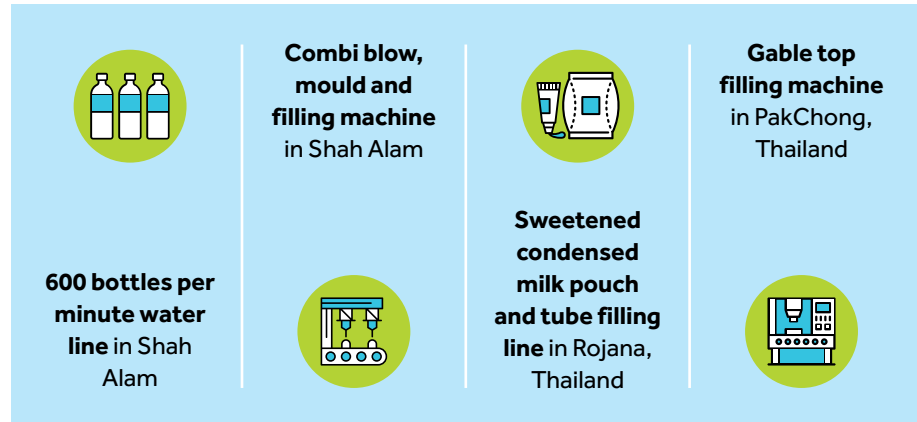
CAPACITY EXPANSION

We followed through with capital expenditure projects announced earlier to increase our production and warehousing capacity, broaden our capabilities, and shorten our route to the different markets we serve. Our objective is to maximise returns from investment, and I believe we are making good headway across the board.

During the year, we added a new Polyethylene Terephthalate (PET) line in the Shah Alam plant; and a RM 31.5 million Ultra-High Temperature (UHT) processing line in Kuching which was officially opened on 14 March 2017. This first-of-its-kind UHT line in Sarawak, will allow the Group to capture increasing demand in East Malaysia with an estimated capacity of over 3.4 million cases a year and create an estimated annual savings of RM 2.8 million by reducing our need to transport products from Peninsula Malaysia.

Two other major projects are ongoing – a mineral water plant expansion in Bentong, Pahang, which is expected to be completed in FY2018; and a cold aseptic PET line and warehouse in Shah Alam. The cold aseptic filling line will be operational beginning 2018 and reduce our resin packaging material usage by 40 per cent while the new warehouse, to be completed in FY2019, is expected to provide significant savings on warehousing cost.

We also plan to invest another RM 200 million worth of manufacturing equipment to further elevate our product innovation and cost competitiveness. Among others, these comprise:



PEOPLE DEVELOPMENT

We recognise that our people are our most valued asset, and have always sought to provide them with continuous development opportunities to fully realise their inherent potential. As a leaner organisation following our transformation, it is even more crucial that our people have the skills and competencies to help us realise our ambitions.

During the year, we invested over RM 2.2 million on training and development, which includes Level 1 of the Operational Engineering Certificate for 25 employees from Malaysia and Thailand, and the ASEAN Management Development Programme under Thai Beverage Group, participated by four members of our management team in June.

We are also encouraging greater knowledge sharing within the Group, with functional group leaders delivering talks to those from other divisions. The idea is to create greater organisational cohesion and for employees to understand how their individual roles support our overall performance. During the year, 58 sessions were held on topics ranging from cyber risk and halal operations to personal development, financial planning and cardiopulmonary resuscitation (CPR), attracting more than 1,800 participants.



We believe employee engagement sessions such as these serve to engender a high level of work satisfaction, hence productivity. To better understand our employees' needs and expectations, and identify key priority areas, we also conducted a biennial employee engagement survey which achieved a high response rate of 99 per cent.

The emphasis placed on creating transparency within the organisation through open communication and regular engagement resulted in a high level of understanding among employees of the necessity of our transformation. Indeed, it is with our employees' full support that we have managed to achieve commendable performance during the year, and are now in a stronger position to take the F&N heritage well into the future.

GOING FORWARD

Although we expect the economic landscape in Malaysia to continue to be challenging, we are optimistic of a rebound in our performance as our capital expenditure projects come to fruition, providing us scope to expand our business. The distributor harmonisation programme should also deliver cross-selling benefits as a larger number of our products reach a growing network of outlets.

Meanwhile, our leaner operating structure will go a long way towards helping us remain competitive in an environment of narrowed margins. Having completed the transformation in Malaysia, the Group will be able to extract synergies and value from improved organisational efficiency and operational savings from the new financial year onwards. Naturally, when we are more cost competitive we will be able to participate more actively in the value segment of the market and gain market share. This is a virtuous cycle that will start to deliver benefits from FY2018.

We will be bold in setting new targets as we deliver greater choice of healthier products to consumers. As an example,

although we had reached an optimal level of sugar for rehydration in 100PLUS, we will push the innovation bar higher by investing more time and effort into further reducing the sugar content without compromising on its rehydrating properties.

The focus in Thailand will be to continue to innovate to further grow. There is scope to grow both F&B Thailand's coverage within the country, as well as develop new product applications and packaging to generate a higher volume of sales. Given the huge success of the squeezable tube for sweetened condensed milk, F&B Thailand is looking at using the format for more innovative products. The business will also look at adjacent product categories and consolidate its positions including in Cambodia and Laos.

As a Group, we will capitalise on the momentum generated by the Exports pillar to further expand the breadth and depth of our international footprint. F&NHB will also place greater emphasis on innovation to drive profitability and boost capabilities that translate into revenue growth.

In managing our risks, which change with the operating environment and market condition, the Group has a dedicated Risk Management Board Committee that meets regularly to discuss emerging risks and mitigation measures. Details on how we are managing our current key risks is outlined in the "Addressing Our Risks & Opportunities" section of this report.

While FY2017 saw the completion of F&N's business transformation to optimise our value chain, the Group will focus on continually refining the way we work to materialise the full benefits of our transformation programme.

As we step into FY2018 as a leaner and stronger organisation, we are now on the right footing to focus on growth opportunities. FY2018 promises to be exciting as we look forward to launching several new products and leverage on the added capacity and capability from the completion of capital expenditure projects to fuel future growth.

Lim Yew Hoe
Chief Executive Officer



Scan the QR code to view the "Up Close with CEO" video.

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