

strategic report >  
**CHIEF EXECUTIVE OFFICER'S STATEMENT**

**Dear Shareholders and Stakeholders,**

**F**ur FY2019 performance reflected the speed and agility gained from our transformation initiatives, our strong research and development capabilities, and the benefits of our push for geographical diversity beyond Malaysia.

**Lim Yew Hoe**

Chief Executive Officer



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 As at the end of the financial year, 90 per cent of our ready-to-drink products sold in Malaysia are healthier options and below 5g sugar per 100ml.  
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The beverages industry in Malaysia went through a significant change in the financial year ended 30 September 2019 (FY2019) with the implementation of an excise tax on sugar sweetened beverages. At the same time, a confluence of geo-political events together with intensifying competition combined to create a challenging macro environment. Yet, F&NHB concluded the year with positive top and bottom line results. All these are made possible through our successful push for greater sales contribution from outside Malaysia.

We further sharpened our competitive edge through better products, greater efficiencies and strengthened relationships with key stakeholders in all our markets.

Our achievements were underlined by three strategic priorities: Innovation, Cost Competitiveness and Excellence in Execution (or I.C.E.). From sourcing raw materials to product formulation/reformulation, production, packaging, distribution and, finally, sales and marketing – we are creating synergies, eliminating waste and enhancing our outcomes.

**SHARPENING OUR COMPETITIVE EDGE WITH I.C.E.**

**HEALTHIER & BETTER PRODUCTS**

Probably the most significant achievement in Malaysia during the year was the successful application of various innovations and technologies to reformulate more than half of our ready-to-drink (RTD) beverages *without compromising on taste*.

It has been our mission to lower our overall sugar index and offer at least one healthier option in every category we are in, as part of our commitment towards improving the health and well-being of our consumers. Thanks to the sweetened beverages excise duty in Malaysia, which was implemented from 1 July 2019, we undertook probably the biggest product innovation exercise in our history and fast-tracked the introductions of the lower sugar products.

As at the end of the financial year, 90 per cent of our RTD products sold in Malaysia are healthier options and below 5g sugar per 100ml. We now have healthier choices in 10 out of 12 of our RTD product categories; and our overall sugar index for 2019 stands at 5.2g per 100ml, 41 per cent lower than when we first started measuring it in 2004. More importantly, all our healthier choice products have been well received, as we are driven by the mantra: "If we don't love it, we won't launch it".

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In addition to the reformulations, this year saw 10 exciting launches which helped to expand our range of products certified by the Healthier Choice Logo of Malaysia's Ministry of Health or Thailand's Ministry of Public Health. From 20 such products in FY2018, we now have 41.

In Malaysia, the new F&N Lychee Pear, F&N SEASONS Apple Pomegranate Tea, F&N SEASONS Watermelon Lychee Tea and F&N SEASONS Pu-Erh Chrysanthemum contain less than 5g of sugar per 100ml.

Meanwhile, the F&N Magnolia Plus Lactose Free milk launched in Thailand caters to the health needs of lactose intolerant consumers. Our current focus in Thailand is on expanding the range of ready-to-drink milk, the natural choice for consumers seeking nutritious beverages, especially senior citizens who are expected to make up 20 per cent of the population by the year 2022.



### CAPTURING VALUE ALONG OUR SUPPLY CHAIN

Cost Competitiveness is critical in the current climate of cost-conscious consumers. Thanks to the various efforts to drive cost efficiencies along the entire supply chain, we have managed, for example, to launch a series of 250ml and 1.2 litre value products that resonate well with consumers – with very encouraging sales during the Hari Raya season.

In response to the increasing competition in Thailand, we introduced the 2kg flexible pouch format for both Carnation and TEAPOT sweetened beverage creamer a few years ago. As they offer greater value for money compared to the can format, they have proven to be extremely popular with restaurateurs as well as hawkers, resulting in all the eight lines currently operating at our plant in Rojana, running at full capacity.

Our employees have been the key drivers of greater efficiencies through innovations to reduce consumption of resources, improve productivity and/or enhance product quality. Initiatives presented under the 'Excel As One' programme this year delivered cost savings or cost avoidance of 18.44 million Baht (RM2.52 million) per annum. In addition, the Quality Excellence team at Rojana Plant developed an initiative that reduced the quarantine period of finished goods, enabling fresher products to be released to the market while achieving annual cost savings of 6.5 million Baht. The initiative has been expanded to our plant in Pulau Indah.

We also drive cost-competitiveness through selective in-sourcing. In the last quarter of FY2019, we completed one of the two additional new empty can making lines at our plant in Pulau Indah. When both lines are in full operation, we would only need minimal external supply for our condensed milk empty cans, providing our Export team with a more cost competitive position.

### CAPEX: SETTING UP FOR THE FUTURE

For the year as a whole, we invested RM150 million on capital expenditure (capex). Among our major ongoing projects are:

- **Shah Alam Warehouse:** This new integrated warehouse with the RM78 million Automated Storage Retrieval System (ASRS) has a capacity of over 50,000 pallet space.

To be completed in FY2021, this capex is expected to increase operational efficiency, provide savings as well as reduce the carbon footprint of our warehouse operations.

- **New Product Development Transformation programme in Shah Alam:** A total of RM30 million has been allocated for new equipment to enable the production of healthier products; and in smaller can format (180ml-250ml). Products such as F&N Classic series (original recipes with full flavour) will be produced in smaller cans and to be launched in time for Chinese New Year 2020.
- **Kota Kinabalu Industrial Park (KKIP) drinking water line and finished goods warehouse:** We have allocated RM20 million capex and started construction work on our first drinking water line in Sabah. The plant, which also houses a finished goods warehouse for products shipped from our Peninsular Malaysia plants, is expected to be completed in FY2020.
- **Solar roof in Rojana plant:** The RM4 million system, with a capacity to produce 1MW of electricity, will be up and running in 2020.
- **In addition, the development of a RM40 million fresh milk line in Pulau Indah is ongoing and is expected to be completed in FY2020.**

PURPOSEFUL ENGAGEMENT WITH CONSUMERS AND CUSTOMERS

In all markets, we worked closely with our distributors to reach out to our increasing customer base more strategically. The fact remains that excellence in execution is not only about driving more sales but also strengthening the connection with our consumers and customers. In selective markets, our sales teams now serve our larger retail customers directly, while our distributors focus on smaller outlets and those in more remote locations.

Rather than partake in value destruction price war, we focus our advertising and promotions budget on building brand loyalty with customers and consumers. As an illustration, the sales team in Thailand has established very strong ties with over 40,000 hawkers as a result of value-added support including the provision of carefully developed new recipes or product applications, in addition to dressing up the hawker stalls. This year, a Line app was launched to engage hawkers by sharing news updates and campaigns. Continued success in marketing and branding initiatives in Thailand and Indochina contributed significantly to the Group's revenue and profit growth.

Through impactful activations and collaborations, we achieved record high sales during the festive seasons in Malaysia. Shipments during Chinese New Year and Hari Raya were the highest in three years in Peninsular Malaysia. In East Malaysia, sales during Gawai (the harvest festival) made up a third of total East Malaysia sales for the year.

Differentiated product packaging further boosted sales by catering to customers' and consumers' new needs. For example, F&N sweetened condensed milk now comes in sizes from single serve 'Stix' pack, convenient squeeze tubes for better flexibility in portion control, to 20kg flexible pouches for bulk industrial usage.

We also drove product applications according to different export market needs, with particularly encouraging results in the Philippines and Africa. The halal market overall performed well, contributing to 26 per cent of our Exports revenue from Malaysia this year.

Besides brand building and route-to-market initiatives, we continue to strengthen our competitive edge through greater focus on operational excellence and developing the right talents, supported by the right tools and skillsets to execute the strategies.

Excellence in execution helped us maintain our leadership in our core categories. In Malaysia, we are No.1 in the carbonated soft drink, tea and canned milk segments. In Thailand, we have retained our leadership in the evaporated milk and total sweetened beverage creamer (SBC) markets with Carnation leading in the Superior segment and TEAPOT maintaining its strong position in the mainstream segment.



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**CATALYSING GROWTH FROM WITHIN**

Since rolling out our Global Values in FY2018, we have been encouraged to witness greater collaboration among our employees especially in knowledge sharing and synergies mining. Believing in the power of Collaboration, Creating Values and Caring for Stakeholders in achieving the organisation's long-term objectives, F&NHB's performance assessment now includes behavioural indicators of the Global Values.

Digital adoption continues to play a key role in many innovations within our organisation. From the Oracle Transport Management (OTM) system that has optimised our route planning to the Enterprise Workflow app which reduces processing time from 14 days to one day, we continue to leverage digital innovation to create value for our people, our partners and our markets.

We also continue to engage our most important stakeholders – our employees – through regular communication and training and development opportunities that support their professional ambitions. CEO roadshows were held throughout Malaysia from June to August this year, followed by a townhall in both Malaysia and Thailand. This year, we also conducted employee engagement survey in September.

We believe developing leaders internally is an important catalyst for growth and competitive advantage. Accordingly, this year, we partnered the Malaysian Institute of Management (MIM) to launch the F&N Future Leaders Development Programme (FLP) 2019 targeting junior executives. FLP focuses on enhancing business acumen, design thinking, problem-solving as well as people management skills.

Together with the Management Development Programme and Asean Management Development Programme under our Group Human Capital Roadmap, we now have talent acceleration programmes to nurture future-ready successors at all levels within the Group. We also positively view gender equity and are proud of the fact that women represent 44 per cent of management roles in our company, a seven per cent increase from FY2018.

**PERFORMANCE IN FY2019**

**W**ithin a volatile environment and continuous competitive pressure, F&NHB concluded the financial year with higher revenue and strong profit. Group revenue rose by 5.3 per cent to RM4.08 billion while profit before tax increased by 25.7 per cent to RM533.0 million.

The Group's profit after tax (PAT) increased by 6.1 per cent from RM386.5 million in FY2018 to RM410.2 million despite the impact of corporate tax payment in Thailand this year, following the full utilisation of the tax incentives granted by the Thailand Board of Investment.

**F&B MALAYSIA**

Amid a disruptive operating environment due to the introduction of the Sales and Service Tax (SST) on 1 September 2018 followed by the sugar tax on 1 July 2019, Food & Beverages Malaysia (F&B Malaysia)'s overall performance was characterised by a turnaround in the beverages business from successful festive promotions.

The combination of factors including the introduction of value packs, intensifying competition in the dairies segment and the absence of a one-off export-oriented contract packing business in the previous year, led to a marginal increase in F&B Malaysia's revenue from RM2.15 billion to RM2.16 billion during the period under review.

F&B Malaysia's operating profit in FY2019 eased 4.2 per cent to RM161.1 million from RM168.1 million in FY2018. Excluding one-off and non-operating items, operating profit for F&B Malaysia was 15.5 per cent higher compared to last year.

**F&B THAILAND**

F&B Thailand continued to be the Group's best performing pillar. Revenue grew by 11.3 per cent year-on-year from RM1.72 billion to RM1.91 billion driven by successful innovations and effective execution of marketing and branding initiatives, supported by capacity expansion and aided by the strengthening Thai Baht against the Ringgit. In local currency terms, revenue for F&B Thailand grew by 5.9 per cent.

Turnover growth, supported by favourable input costs and internal efficiencies, led to a 40.3 per cent increase in F&B Thailand's operating profit (33.5 per cent in local currency) to RM362.0 million from RM258.0 million in FY2018.

**EXPORTS\***

Exports faced several headwinds in FY2019 which included macro-economic uncertainties induced by the US-China trade war and geo-political tension in the Middle East, as well as reduced export competitiveness due to the strong Baht.

Within this landscape, Exports from Malaysia expanded to seven new markets while F&B Thailand's export markets of Cambodia and Laos continued to perform strongly at double-digit growth. The latter was driven primarily by the introduction of TEAPOT Sweetened Beverage Creamer Squeeze Tubes which have been well received.

Moving forward, we remain committed to building Exports as our third business pillar and achieving target Group export sales of RM800 million by 2020. A new subsidiary in Dubai is to open soon, to increase and deepen our presence in the Middle East and North Africa regions as we expect halal markets to contribute RM100 million to the Group revenue in FY2020.

**WAY FORWARD – TOWARDS INCLUSIVE GROWTH**

**P**our three growth enablers – Innovation, Cost Competitiveness, Excellence in Execution – will continue to guide our Inclusive Growth strategy, which encompasses:

- Creating value for our people, consumers, business partners, shareholders and the society we operate in;
- Growing our brands and portfolio of products to win in more markets;
- Growing the breadth and depth of our market reach including e-commerce, exports and the B2B segment.

\* Financial performance of Exports are included in F&B Malaysia and F&B Thailand segment results.



**ESTABLISHING OUR FOURTH PILLAR**

Recognising the need to do things differently to stay relevant, we have made the bold decision to develop dairy farming as our fourth pillar. We are in the process of acquiring 4,454 hectares of land in Chuping, Perlis to explore the upstream insourcing of fresh milk to support existing downstream production and distribution of fresh milk products. The aim is eventually to house 20,000 milking cows and produce 200 million litres of fresh milk per annum.

For us, the farm would resolve the perennial issue of sourcing fresh milk while accelerating our presence in the liquid milk sector, where there is huge potential for growth. For the nation, it would go a long way towards ensuring fresh milk and dairy self-sufficiency.

In addition, with our farm providing the readily available and more affordable milk, we believe we will be further enhancing the role we have adopted in helping to shape a healthier nation. The many benefits that the integrated dairy farm project will bring are set to further entrench our position as a 136 years old trusted and responsible corporate citizen.

**DELIVERING VALUE: GOING HEALTHIER & GREENER**

A key priority as we move into the future is to deepen our connection with consumers with products that satisfy their needs and aspirations as we step up our contributions to manage global environmental issues. We have a number of exciting launches lined up in FY2020, many that will expand our portfolio of healthier options.

At the same time, we are investing into more green initiatives to minimise our carbon footprint – from installing a solar roof at our plant in Rojana to increasing the use of recyclable material in our packaging. Our goal is to eventually embrace a circular economy in which we prioritise renewable inputs, keep our products and materials in use, and recover all by-products and waste.

We have already made a positive start in this regard through our school recycling programme. This financial year (11<sup>th</sup> year of the School Recycling Programme), we achieved a marked increase in participation in the programme, with a quadrupling in volume of recyclable materials collected to 2.35 million kilogrammes across 13 states in Malaysia. We are proud of this programme and will keep growing it as we seek to enhance Malaysia’s overall recycling rate.

**SCALING UP E-COMMERCE/ DIGITALISATION**

After leveraging the online platforms of retailers such as 11street, Shopee, JOCOM and Lazada over the past few years, we are ready to take our e-commerce business to the next level. In FY2020, we will be launching F&N Life, our flagship online store and mobile application while setting up an e-commerce shop in T-mall, one of China’s biggest business to consumer (B2C) players.

With the growing importance of social media, the ways we conduct our marketing activities, particularly the way we interact with consumers, will also evolve. Social listening is fast becoming another important channel, while one of the most important decisions in marketing is now in balancing funds allocation between the traditional and new media. Either way, we have to learn quickly, and embrace the change to achieve sustainability of growth, especially among the young consumers.

**ACKNOWLEDGEMENTS**

Our successes to date are due to a large number of stakeholders. We value our shareholders for your trust in our ability to deliver sustainable returns on your investments. To our suppliers, distributors and customers, I would like to extend our appreciation for your steadfast willingness to share our vision. To our consumers, thank you for your continued support and brand loyalty.

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 The many benefits that the integrated dairy farm project will bring are set to further entrench our position as a 136 years old trusted and responsible corporate citizen.  
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Finally, my appreciation goes to the entire F&NHB family. I would like to express my gratitude to the Board of Directors for your wisdom and strategic counsel, and members of the management team for your tireless contributions. I especially like to take this opportunity to personally thank Mr. Tan Hock Beng, our Senior Director, Procurement and Special Projects and former Chief Financial Officer, who retires on 30 November 2019. Hock Beng has been with us for 18 years and has been instrumental in driving the overall dairy business growth.

My deep appreciation also extends to Khun Karn Chitaravimol, who retired as Managing Director of F&N Dairies (Thailand) Limited on 1 April 2019.

As for all our employees, *terima kasih* and *khob khun krub* for your hard work and commitment to our shared vision and objectives. We are on the cusp of some very exciting changes, and truly look forward to creating a better future for the company as well as our stakeholders with your continued support.

**Lim Yew Hoe**  
 Chief Executive Officer