

# Leong Hup International (LHIB MK)

## Issues profit warning

# BUY

Share Price MYR 0.85  
 12m Price Target MYR 1.08 (+27%)  
 Previous Price Target MYR 1.37

### Still a good regional play; BUY with 20% lower TP

What has negatively surprised us is that poultry ASPs have been much weaker than we expected, particularly in Malaysia, offsetting the increase in production volume. Taking LHIB's profit warning into account, we have cut our FY19-21E net profit by 20-24% ahead of its 2Q19 results release and lowered our TP by 20% to MYR1.08. Commodity price volatility aside, the group's regional expansion is bearing fruit, as borne out by the growth in production volumes, and LHIB is still one of Malaysia's better regional plays, in our view. BUY maintained.

### Expects significantly lower YoY net profit

Management cautions, in a Bursa announcement, that the group will record significantly lower YoY net profit in 2Q19, largely as a result of the drop in average selling prices (ASPs), particularly in Malaysia. LHIB's ASP for day-old-chicks (DOC) in Malaysia was MYR1.21/DOC in 2Q19 (low of MYR0.90), down 39% YoY from MYR1.97/DOC in 2Q18. The ASP for Malaysian broilers was MYR3.99/kg in 2Q19 (low of MYR2.60/kg), down 15% YoY from MYR4.68/kg in 2Q18.

### Sales volume, nevertheless, rose

Management highlighted that overall 2Q19 sales volume for feed, DOCs, broilers and eggs increased YoY by 13.9%, 8.1%, 10.7% and 5.9%, respectively. Feed growth was strong, led by capacity expansion in Malaysia and Vietnam, in 2018. Operating costs were stable but with falling ASPs, overall margins contracted in 2Q19.

### Cut forecasts and TP

Taking into account the profit warning, we have cut our net profit forecasts by 24%/21%/20% for FY19/20/21E on expectations of lower operating margins. To note that Malaysia's DOC and broiler ASPs rebounded by about 32% in July 2019 from the average in 2Q19 and should provide some support to earnings in 2H19, if sustained. Assuming constant ASPs, we expect capacity expansion to drive topline growth into FY21. Our revised TP of MYR1.08 remains pegged to the regional peer average FY20 PER of 17x.

FYE Dec (MYR m)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	5,501	5,747	6,137	6,600	7,094
EBITDA	583	655	696	764	836
Core net profit	193	225	197	232	266
Core EPS (sen)	5.3	6.2	5.4	6.3	7.3
Core EPS growth (%)	5.5	16.8	(12.5)	17.8	14.9
Net DPS (sen)	0.0	0.0	1.6	1.9	2.2
Core P/E (x)	na	na	15.8	13.4	11.7
P/BV (x)	na	na	1.8	1.7	1.5
Net dividend yield (%)	na	na	1.9	2.2	2.6
ROAE (%)	15.4	15.0	13.0	12.9	13.5
ROAA (%)	4.4	4.8	3.8	4.0	4.2
EV/EBITDA (x)	9.0	8.4	7.8	7.3	6.8
Net gearing (%) (incl perps)	103.0	108.3	79.1	73.6	66.4
Consensus net profit	-	-	247	272	319
MKE vs. Consensus (%)	-	-	(20.2)	(14.7)	(16.7)

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### Company Description

The company is an integrated poultry player with operations across Malaysia, Singapore, Indonesia, Vietnam and the Philippines

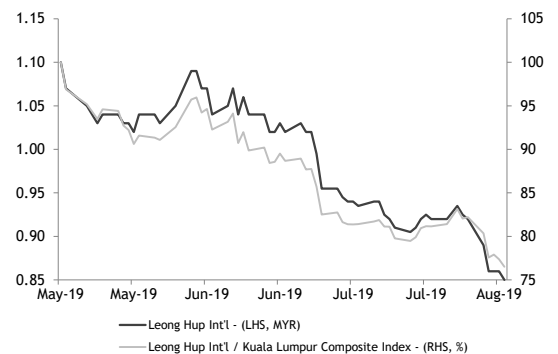
### Statistics

52w high/low (MYR)	na/na
3m avg turnover (USDm)	2.6
Free float (%)	27.4
Issued shares (m)	3,650
Market capitalisation	MYR3.1B USD741M

### Major shareholders:

Emerging Glory	52.8%
Clarinden Investments	9.0%

### Price Performance



	-1M	-3M	-12M
Absolute (%)	(10)	na	na
Relative to index (%)	(6)	na	na

Source: FactSet

Fig 1: Regional and domestic peer comparisons

Stock	Shr px *	Mkt cap (MYR)	PER (x)	PER (x)	P/B (x)	P/B (x)	2-yr EPS CAGR	2-yr PEG	ROAE (%)	ROAE (%)	Net yield (%)
	(Local)		CY19F	CY20F	CY19F	CY20F	(%)	(x)	CY19F	CY20F	CY19F
Leong Hup	0.85	3,103	15.5	13.2	1.8	1.6	2.4	6.6	13.3	13.1	1.9
CP Foods ^	27.75	31,668	19.0	17.7	1.4	1.3	(6.6)	(2.9)	7.4	8.2	2.4
CP Indo	4,940	23,321	22.8	19.3	3.8	3.4	(3.9)	(5.8)	17.2	17.4	2.0
Japfa Ltd	0.49	2,667	10.3	8.2	0.8	0.7	(11.1)	(0.9)	7.0	9.0	2.3
Japfa Comfeed	1,565	5,283	10.5	9.2	1.7	1.5	(3.9)	(2.7)	16.1	17.2	3.1
GFPT	18.50	3,074	16.3	14.3	1.7	1.6	25.0	0.7	10.7	10.9	1.7
<b>Regional wtd avg</b>		<b>66,013</b>	<b>19.2</b>	<b>17.0</b>	<b>2.3</b>	<b>2.0</b>	<b>(4.2)</b>	<b>(4.6)</b>	<b>11.7</b>	<b>12.1</b>	

Source: Bloomberg, Maybank KE

## Key risk factors

### Obtaining proper business certifications

Leong Hup is still in the midst of obtaining the relevant Certificate of Complete and Compliance (CCC) for the right to occupy any building or part thereof for all its 137 farms and hatcheries in Malaysia. Similarly, in Indonesia, local regulations require a Certificate of Feasible Function for the right to occupy and utilise a building, but as of Mar 2019, 70 of the buildings under Malindo Group had yet to obtain proper land use certification. Without proper compliance to certification requirements, Leong Hup's Malaysian and Indonesian operations are at the risk of being halted and possibly receiving penalties.

### Interruptions in breeding stock supply

Leong Hup imports its entire Broiler breeding stock (GPS DOCs) from its suppliers, Cobb-Vantress and Aviagen. Given the limited number of breeders available worldwide, Leong Hup's supply of GPS DOCs could be disrupted if either Cobb-Vantress or Aviagen are unable to supply GPS DOCs for commercial reasons or because of an adverse event impacting their own businesses; this, in turn would slow Leong Hup's supply of parent stock (PS) DOCs for its breeding business, ultimately causing delays to its entire supply chain.

### Livestock disease outbreak

An outbreak of livestock disease (e.g. Avian Influenza) in any of the group's operating countries could be detrimental to profitability, as all the birds within an infected area must be culled to ensure that the virus remains in the containment zone. Additionally, any disease outbreak could affect consumer sentiment, decreasing demand for poultry food products for an extended period of time. Leong Hup does not have insurance coverage against losses resulting from livestock disease as such policies are scarce and not customary in its country of operations.

### Raw material price volatility

Corn and soybean meal are commodities heavily used in the feedmill business. Leong Hup imports the majority of both its corn and soybean meal requirements. Hence, as both corn and soybean meal are traded on the international market, it is vital for management to monitor fluctuations in prices and availability to manage its raw material costs.

### Dependence on foreign workers

Poultry farming is labour intensive. As at 30 Jun 2018, 49.8% of Leong Hup's employees in Malaysia were foreign workers from Indonesia, Nepal and Bangladesh, while 56.6% of its employees in Singapore were from Malaysia, China and Indonesia. Day-to-day operations may be disrupted should there be any changes in labour regulations or difficulties in recruiting foreign workers.

### Interests of controlling shareholder

Emerging Glory is a controlling shareholder and through its ability to influence the election of Leong Hup's Directors, will have control over matters concerning the group. There is no guarantee that its interests will remain aligned with those of other shareholders of the group.

FYE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Key Metrics</b>					
P/E (reported) (x)	na	na	15.8	13.4	11.7
Core P/E (x)	na	na	15.8	13.4	11.7
P/BV (x)	na	na	1.8	1.7	1.5
P/NTA (x)	na	na	1.9	1.7	1.6
Net dividend yield (%)	na	na	1.9	2.2	2.6
FCF yield (%)	na	na	nm	1.2	3.3
EV/EBITDA (x)	9.0	8.4	7.8	7.3	6.8
EV/EBIT (x)	13.7	12.0	11.3	10.5	9.7
<b>INCOME STATEMENT (MYR m)</b>					
Revenue	5,501.4	5,746.6	6,136.9	6,600.3	7,093.9
Gross profit	912.6	1,005.8	1,031.3	1,112.6	1,200.3
EBITDA	583.1	654.6	696.0	763.9	835.6
Depreciation	(189.1)	(189.9)	(208.7)	(227.8)	(244.0)
Amortisation	(10.0)	(7.2)	(7.2)	(7.2)	(7.2)
EBIT	384.0	457.5	480.1	528.9	584.4
Net interest income / (exp)	(92.2)	(109.5)	(116.8)	(126.7)	(134.5)
Associates & JV	0.5	0.6	0.6	0.7	0.7
Pretax profit	292.3	348.6	363.9	402.9	450.5
Income tax	(44.9)	(101.8)	(81.9)	(90.7)	(101.4)
Minorities	(54.8)	(60.6)	(85.3)	(80.7)	(83.0)
Reported net profit	192.6	186.2	196.7	231.6	266.1
Core net profit	192.6	224.9	196.7	231.6	266.1
<b>BALANCE SHEET (MYR m)</b>					
Cash & Short Term Investments	502.4	458.9	704.5	934.7	1,219.3
Accounts receivable	564.0	649.2	695.9	750.8	804.1
Inventory	516.8	575.6	655.3	667.8	753.2
Reinsurance assets	0.0	0.0	0.0	0.0	0.0
Property, Plant & Equip (net)	2,045.8	2,216.8	2,420.4	2,592.9	2,749.1
Intangible assets	106.5	97.3	97.0	96.7	96.4
Investment in Associates & JVs	1.6	1.7	1.7	1.7	1.7
Other assets	740.3	834.5	928.2	986.9	1,048.5
<b>Total assets</b>	<b>4,477.5</b>	<b>4,834.0</b>	<b>5,503.0</b>	<b>6,031.3</b>	<b>6,672.4</b>
ST interest bearing debt	1,419.1	1,326.6	1,465.4	1,633.0	1,800.6
Accounts payable	242.2	248.9	310.6	290.8	355.1
Insurance contract liabilities	0.0	0.0	0.0	0.0	0.0
LT interest bearing debt	774.4	1,044.3	1,030.3	1,145.5	1,260.7
Other liabilities	400.0	449.0	433.0	456.0	480.0
<b>Total Liabilities</b>	<b>2,835.5</b>	<b>3,068.6</b>	<b>3,239.5</b>	<b>3,525.1</b>	<b>3,896.8</b>
Shareholders Equity	1,185.6	1,301.8	1,714.5	1,876.6	2,062.9
Minority Interest	456.4	463.6	548.9	629.6	712.6
<b>Total shareholder equity</b>	<b>1,642.0</b>	<b>1,765.4</b>	<b>2,263.4</b>	<b>2,506.2</b>	<b>2,775.6</b>
<b>Total liabilities and equity</b>	<b>4,477.5</b>	<b>4,834.0</b>	<b>5,503.0</b>	<b>6,031.3</b>	<b>6,672.4</b>
<b>CASH FLOW (MYR m)</b>					
Pretax profit	292.3	348.6	363.9	402.9	450.5
Depreciation & amortisation	199.1	197.1	215.9	235.0	251.2
Cash taxes paid	(44.9)	(101.8)	(81.9)	(90.7)	(101.4)
Other operating cash flow	0.0	0.0	0.0	0.0	0.0
Cash flow from operations	405.5	289.0	335.5	436.2	501.1
Capex	(281.8)	(397.1)	(412.0)	(400.0)	(400.0)
Free cash flow	123.7	(108.1)	(76.5)	36.2	101.1
Dividends paid	(459.7)	(50.0)	(59.0)	(69.5)	(79.8)
Equity raised / (purchased)	0.0	(0.0)	275.0	0.0	0.0
Change in Debt	562.8	178.1	124.7	282.8	282.8
Other invest/financing cash flow	(137.4)	(63.6)	(18.6)	(19.4)	(19.4)
Net cash flow	89.4	(43.5)	245.6	230.2	284.7

FYE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Key Ratios</b>					
<b>Growth ratios (%)</b>					
Revenue growth	4.6	4.5	6.8	7.6	7.5
EBITDA growth	(9.8)	12.3	6.3	9.8	9.4
EBIT growth	(14.6)	19.1	5.0	10.2	10.5
Pretax growth	(15.8)	19.3	4.4	10.7	11.8
Reported net profit growth	5.5	(3.3)	5.6	17.8	14.9
Core net profit growth	5.5	16.8	(12.5)	17.8	14.9
<b>Profitability ratios (%)</b>					
EBITDA margin	10.6	11.4	11.3	11.6	11.8
EBIT margin	7.0	8.0	7.8	8.0	8.2
Pretax profit margin	5.3	6.1	5.9	6.1	6.4
Payout ratio	0.0	0.0	30.0	30.0	30.0
<b>DuPont analysis</b>					
Net profit margin (%)	3.5	3.2	3.2	3.5	3.8
Revenue/Assets (x)	1.2	1.2	1.1	1.1	1.1
Assets/Equity (x)	3.8	3.7	3.2	3.2	3.2
ROAE (%)	15.4	15.0	13.0	12.9	13.5
ROAA (%)	4.4	4.8	3.8	4.0	4.2
<b>Liquidity &amp; Efficiency</b>					
Cash conversion cycle	57.8	60.8	63.1	63.1	63.1
Days receivable outstanding	35.7	38.0	39.5	39.5	39.5
Days inventory outstanding	41.7	41.5	43.4	43.4	43.4
Days payables outstanding	19.6	18.6	19.7	19.7	19.7
Dividend cover (x)	nm	nm	3.3	3.3	3.3
Current ratio (x)	1.1	1.2	1.3	1.4	1.4
<b>Leverage &amp; Expense Analysis</b>					
Asset/Liability (x)	1.6	1.6	1.7	1.7	1.7
Net gearing (%) (incl perps)	103.0	108.3	79.1	73.6	66.4
Net gearing (%) (excl. perps)	103.0	108.3	79.1	73.6	66.4
Net interest cover (x)	4.2	4.2	4.1	4.2	4.3
Debt/EBITDA (x)	3.8	3.6	3.6	3.6	3.7
Capex/revenue (%)	5.1	6.9	6.7	6.1	5.6
Net debt/ (net cash)	1,691.1	1,912.1	1,791.2	1,843.8	1,841.9

Source: Company; Maybank

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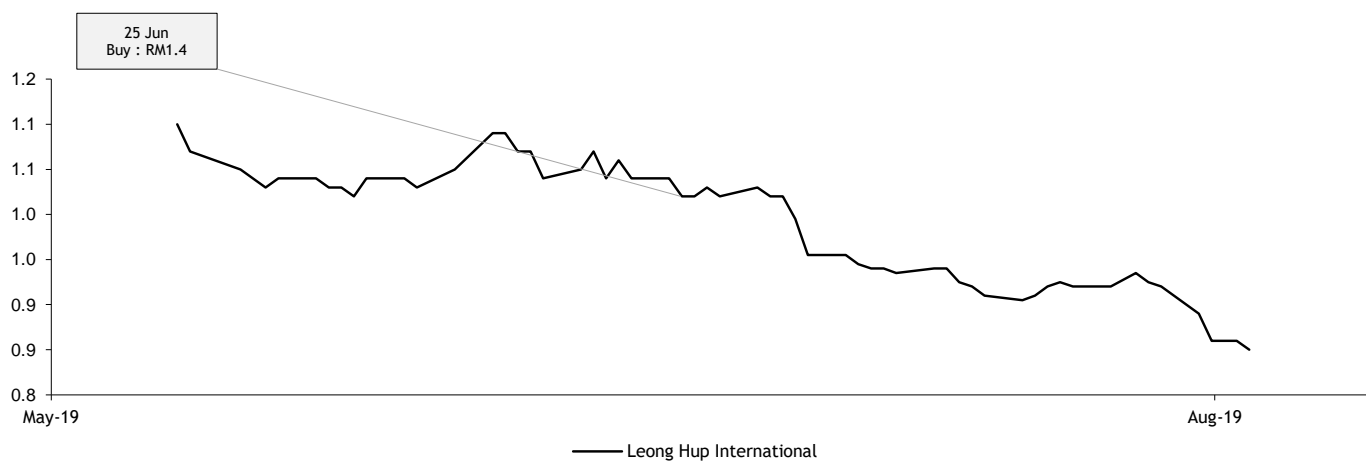
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