

**HLIB Research**

PP 9484/12/2012 (031413)

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**BUY** (Initiate)

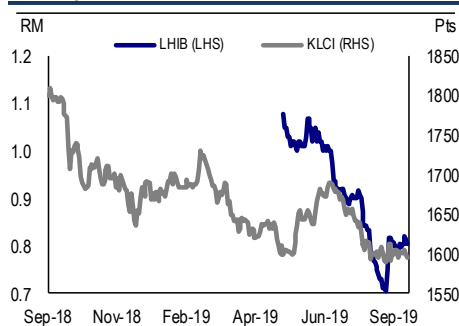
**Target Price:** **RM1.10**
**Previously:** -

**Current Price:** **RM0.805**

Capital upside	36.6%
Dividend yield	2.0%
Expected total return	38.6%

**Sector coverage:** Poultry

**Company description:** LHI offers breeding, egg production, broiler, and livestock feeding solutions, as well as manufactures chicken products in Malaysia, Singapore, Indonesia, Vietnam and Philippines.

**Share price**


Historical return (%)	1M	3M	12M
Absolute	4.5	-22.6	N/A
Relative	4.6	-19.2	N/A

**Stock information**

Bloomberg ticker	LHIB MK
Bursa code	6633
Issued shares (m)	3,650
Market capitalisation (RM m)	2,938
3-mth average volume ('000)	4,070
SC Shariah compliant	No

**Major shareholders**

Emerging Glory	52.8%
Clariden Investments	9.0%

**Earnings summary**

FYE (Dec)	FY18a	FY19f	FY20f
PATMI – core	219.6	194.2	223.5
EPS – core (sen)	6.0	5.3	6.1
P/E (x)	13.4	15.1	13.1

# Leong Hup International

## A pure poultry play in SEA region

LHI is one of the largest fully integrated producers of poultry, eggs and livestock feeds in Southeast Asia (SEA) region. Having reflected the weak livestock prices in 2Q19, we project core net profit to decline by 11.6% to RM194.2m in FY19. We forecast FY20-21 core net profit to increase by 15.1-15.2% to RM233.5m and RM257.5m, underpinned by higher livestock and feedmill sales volume (arising from capacity expansion). We initiate coverage on LHI with a BUY rating and TP of RM1.10 based on 18x FY20 EPS of 6.1 sen.

**Background.** LHI is one of the largest fully integrated producers of poultry, eggs and livestock feeds in SEA region, with operations in Malaysia, Singapore, Indonesia, Vietnam and the Philippines. LHI's operations can be classified into 2 major segments, namely feedmill and livestock segments.

**Operating in fast-growing ASEAN consumer markets with rising poultry consumption.** LHI operates in SEA with significant growth potential, underpinned by (i) favourable age demographic and growing population, (ii) increasing affluence and disposable income, and (iii) significant growth potential in the consumption of proteins, in particular, poultry meat.

### Ongoing expansion plans to further strengthen LHI's foothold in SEA region.

LHI is still in expansion mode in the near future (of which it has planned capex of RM437m in FY19) in order to strengthen its presence in the SEA region (in particular, the 5 markets it operates in). Besides, we note that LHI is exploring Cambodian market through livestock imports, and may enter production there in the future when it sees sufficient demand from local customers.

**Lower feed prices – a boon to livestock production cost.** The primary raw materials for LHI's feedmill business are corn and soybean meal. We note that prices of both corn and soybean meal have eased since Jul-19. Lower feed prices augur well for livestock production cost, as feed is the main cost component in producing livestock.

**Strong economies of scale.** LHI is the largest integrated poultry producer in Malaysia and among the top 3 integrated producers in Indonesia and Vietnam. The sheer production size gives LHI an advantage over smaller competitors in the sourcing of raw materials, production and distribution of poultry and livestock feeds.

**Fully-integrated business model.** The integrated business model provides LHI with significant competitive advantage over other non-integrated players in terms of operating flexibility and resilience.

**Forecast.** We project a core net profit of RM194.2m in FY19 (-11.6% YoY), as we expect LHI's performance to recover in 2H19 (1H19: -35.6%), underpinned by a recovery in livestock prices in Malaysia and Indonesia, and higher livestock and feedmill sales volume. We project FY20-21 core net profit to increase by 15.1-15.2% to RM233.5m and RM257.5m, underpinned by higher livestock and feedmill sales volume (arising from capacity expansion).

**Initiate with BUY; TP of RM1.10.** We initiate coverage on LHI with a BUY rating and TP of RM1.10 based on 18x FY20 EPS of 6.1 sen. At current share price of RM0.805, we believe the weak 2Q19 performance has already been more than reflected in recent share price performance (which has plunged 26% since IPO listing), and we expect LHI's performance to recover considerably in 2H19, underpinned by (i) a strong recovery in broiler and DOC prices in Malaysia and Indonesia; and (ii) higher capacity at both feedmill and livestock segments.

## Financial Forecast

All items in (RM m) unless otherwise stated

### Balance Sheet

FYE Dec	FY17a	FY18a	FY19f	FY20f	FY21f
Cash	502.4	458.9	719.7	776.7	885.7
Receivables	696.1	825.5	826.8	869.2	906.4
Inventories	516.8	575.6	596.5	627.1	654.0
PPE	2,045.8	2,216.8	2,439.0	2,560.3	2,671.6
Others	716.4	756.4	770.8	781.0	788.9
<b>Assets</b>	<b>4,477.5</b>	<b>4,834.0</b>	<b>5,353.6</b>	<b>5,615.1</b>	<b>5,907.5</b>
Payables	498.9	519.9	569.4	598.6	624.3
Debt	2,143.9	2,320.8	2,320.8	2,320.8	2,320.8
Others	192.7	228.0	228.0	228.0	228.0
<b>Liabilities</b>	<b>2,835.5</b>	<b>3,068.6</b>	<b>3,118.1</b>	<b>3,147.4</b>	<b>3,173.0</b>
Shareholder's equity	1,185.6	1,301.8	1,707.1	1,865.0	2,045.8
Minority interest	456.4	463.6	528.3	602.8	688.6
<b>Equity</b>	<b>1,642.0</b>	<b>1,765.4</b>	<b>2,235.5</b>	<b>2,467.8</b>	<b>2,734.5</b>

### Cash Flow Statement

FYE Dec	FY17a	FY18a	FY19f	FY20f	FY21f
Profit before taxation	292.3	348.6	345.0	397.2	457.7
D&A	199.1	197.1	227.3	238.1	248.0
Working capital	11.4	(241.8)	4.1	(62.9)	(55.2)
Taxation	(76.2)	(75.7)	(86.1)	(99.2)	(114.3)
Others	97.9	121.2	92.9	79.0	79.0
<b>CFO</b>	<b>524.4</b>	<b>349.3</b>	<b>583.0</b>	<b>552.2</b>	<b>615.2</b>
Capex	(368.1)	(423.0)	(440.0)	(350.0)	(350.0)
Others	1.5	44.4	-	-	-
<b>CFI</b>	<b>(366.7)</b>	<b>(378.6)</b>	<b>(440.0)</b>	<b>(350.0)</b>	<b>(350.0)</b>
Changes in debt	536.6	178.9	-	-	-
Shares issued	-	-	269.6	-	-
Dividends	(38.4)	(58.0)	(58.4)	(65.7)	(76.7)
Others	(570.1)	(127.8)	(93.4)	(79.5)	(79.5)
<b>CFF</b>	<b>(71.9)</b>	<b>(6.9)</b>	<b>117.8</b>	<b>(145.2)</b>	<b>(156.2)</b>
<b>Net cash flow</b>	<b>85.8</b>	<b>(36.2)</b>	<b>260.8</b>	<b>57.0</b>	<b>109.0</b>
Forex	8.4	(0.8)	-	-	-
Others	-	-	-	-	-
Beginning cash	333.2	427.4	390.4	651.2	708.2
Ending cash	427.4	390.4	651.2	708.2	817.2

### Income Statement

FYE Dec	FY17a	FY18a	FY19f	FY20f	FY21f
Revenue	5,501.4	5,746.6	5,965.5	6,271.4	6,540.0
EBITDA	583.1	654.6	665.1	714.3	784.7
EBIT	384.0	457.5	437.9	476.2	536.7
Finance cost	(92.2)	(109.5)	(93.4)	(79.5)	(79.5)
Associates	0.5	0.6	0.5	0.5	0.5
Profit before tax	292.3	348.6	345.0	397.2	457.7
Tax	(44.9)	(101.8)	(86.1)	(99.2)	(114.3)
PAT	247.4	246.8	258.9	298.0	343.4
Minority interest	(54.8)	(60.6)	(64.7)	(74.5)	(85.8)
Reported PATMI	192.6	186.2	194.2	223.5	257.5
Exceptionals	(6.1)	33.4	-	-	-
<b>Core PATMI</b>	<b>186.4</b>	<b>219.6</b>	<b>194.2</b>	<b>223.5</b>	<b>257.5</b>

### Ratios

FYE Dec	FY17a	FY18a	FY19f	FY20f	FY21f
Core EPS (sen)	5.1	6.0	5.3	6.1	7.1
P/E (x)	15.8	13.4	15.1	13.1	11.4
EV/EBITDA (x)	8.2	7.3	7.2	6.7	6.1
DPS (sen)	-	-	1.6	1.8	2.1
Dividend Yield	-	-	2.0	2.2	2.6
BVPS (RM)	0.3	0.4	0.5	0.5	0.6
P/B (x)	2.5	2.3	1.7	1.6	1.4
EBITDA margin	10.6%	11.4%	11.1%	11.4%	12.0%
EBIT margin	7.0%	8.0%	7.3%	7.6%	8.2%
PBT margin	5.3%	6.1%	5.8%	6.3%	7.0%
Net margin	3.4%	3.8%	3.3%	3.6%	3.9%
ROE	11.4%	12.4%	8.7%	9.1%	9.4%
ROA	4.2%	4.5%	3.6%	4.0%	4.4%
Net gearing	100.0%	105.5%	71.6%	62.6%	52.5%

### Assumptions

FYE Dec	FY19f	FY20f	FY21f
<b>Feedmill</b>			
- Production volume ('000 mt)	2,170.4	2,291.3	2,392.9
- Utilisation rate	65.8%	66.9%	67.4%
- External sales ('000 mt)	1,452.2	1,545.5	1,618.1
<b>Livestock</b>			
- Broiler supplied (m birds)	133.5	150.5	162.1
- Eggs supplied (m eggs)	1,756.7	1,832.6	1,913.1

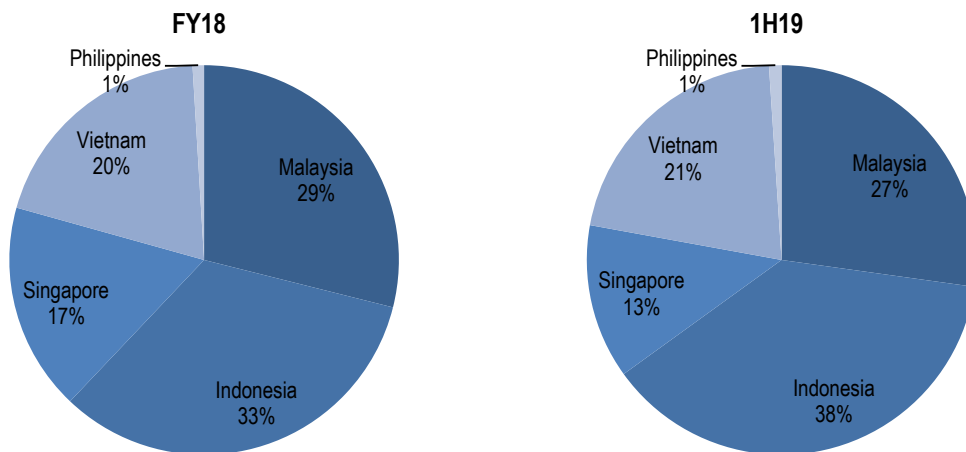
LHI; HLIB Research

## Background

**One of the largest integrated players in SEA region.** Established in Malaysia in the 1960's and listed on Bursa's Main Market on 16 May 2019, Leong Hup International Berhad (LHI) is one of the largest fully integrated producers of poultry, eggs and livestock feeds in Southeast Asia (SEA) region, with operations in Malaysia, Singapore, Indonesia, Vietnam and the Philippines.

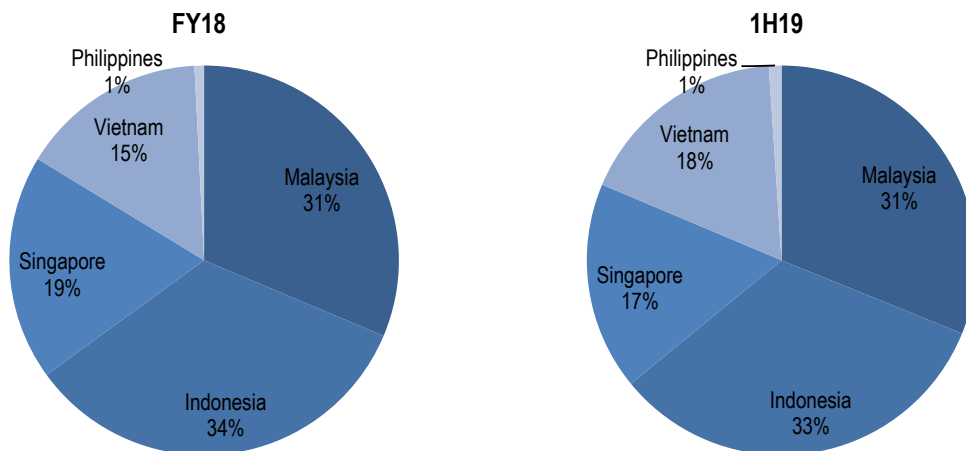
Geographically, both Malaysia and Indonesia account for more than 60% of LHI's revenue and EBITDA, while Vietnam and Singapore makes up the remainder. Contribution from Philippines remains insignificant (~1%) given that it is a new market to LHI.

**Figure #1 Revenue breakdown by countries**



LHI; HLIB

**Figure #2 EBITDA breakdown by countries**



LHI; HLIB

LHI's operations can be classified into 2 major businesses:

- Feedmill business, which includes formulation, production and sale of livestock feeds for a variety of livestock; and
- Livestock business, which includes (i) rearing of grandparent stock day old chicks (GPS DOCs) in order to produce parent stock day old chicks (PS DOCs) and broiler day old chicks (broiler DOCs) for internal use and external sale, and the rearing and sale of broiler chicken, (ii) rearing of parent stock layer day old chicks (PS layer DOCs) in order to produce layer day old chicks (layer DOCs), and the rearing of layer chickens in order to produce eggs, (iii) rearing of parent stock ducks (PS ducks) in order to produce broiler day old ducks (broiler DODs), and the rearing and sale of broiler duck, and (iv) distribution of fresh and processed downstream consumer food products.

## Feedmill business

**A major feedmill player in SEA region.** LHI is the largest integrated producer of livestock feeds in Malaysia and the third largest in Indonesia and Vietnam (in terms of annual production output), under the brands of “Leong Hup” (in Malaysia and Vietnam), “Malindo” (in Indonesia), “Gymtech” and “Emivest” (for other livestock feeds in Vietnam), and A88 (for other livestock feeds in Indonesia). LHI owns and operates 5 feedmills in Malaysia, 5 in Indonesia and 3 in Vietnam. These feedmills are strategically located with transportation links to ports and poultry farming areas, thereby increasing efficiency and reducing LHI’s transportation costs. As at 30 Jun 2019, LHI had total production feedmill capacity of circa 3.5m tonnes per annum.

LHI’s feedmill business provides almost all of the livestock feeds required for its livestock businesses in Malaysia, Indonesia and Vietnam, and it only purchases a small quantity of livestock feeds from third parties. LHI operates its Indonesia feedmill business through Malindo Feedmill, a public company listed on the Indonesia Stock Exchange since 10 Feb 2006 (which LHI has 57.27% stake through its wholly-owned subsidiary Dragon Amity).

**Market share.** In 2017, LHI had market share of approximately 10.5%, 5.5% and 4% in Malaysia, Indonesia and Vietnam, respectively, in terms of annual production of livestock feeds.

## Livestock business

**Vertically integrated business model.** In combination with its feedmill business, LHI’s livestock business is vertically integrated, which covers the entire poultry value chain. LHI’s poultry business began in Malaysia, and the business model was subsequently replicated and expanded across Southeast Asia region (namely, Indonesia, Vietnam and the Philippines). Besides, LHI undertakes processing activities, which comprise the slaughtering of poultry and food processing.

The two principal business operations within LHI’s livestock business are (i) chicken production, and (ii) egg production. Chicken production consists of the production of PS DOCs, broiler DOCs and broiler chicken, slaughtering of broiler chicken and further food processing. Egg production consists of production of table eggs.

**Malaysia.** LHI is the largest integrated producer in Malaysia, with a market share of 27%, by annual supply of DOCs as at 31 Dec 2017. Of the broiler chickens it produces in Malaysia (which are halal certified), LHI slaughters approximately 5% in the slaughtering plant that it operates in Malaysia, transport approximately 25% to Singapore, and sell the remainder to wholesalers, wet market traders and third-party slaughtering plants. As for its food processing operations in Malaysia, LHI markets its branded products (including “SunnyGold” and “Ayam A1”) to supermarkets and distributors. As for egg production, LHI operates its egg production segment through Teo Seng Group (which is listed on the Main Board of Bursa Malaysia Securities and LHI has an effective interest of 26.83% as at 31 Jul 2018). Teo Seng had the second highest annual production of eggs among the public listed integrated poultry companies in Malaysia, with total egg production of 1.29bn eggs. Teo Seng primarily sells its eggs as table eggs, and also markets premium eggs under the brand “Happy Egg”. The eggs are largely sold in Malaysia, Singapore and Hong Kong.

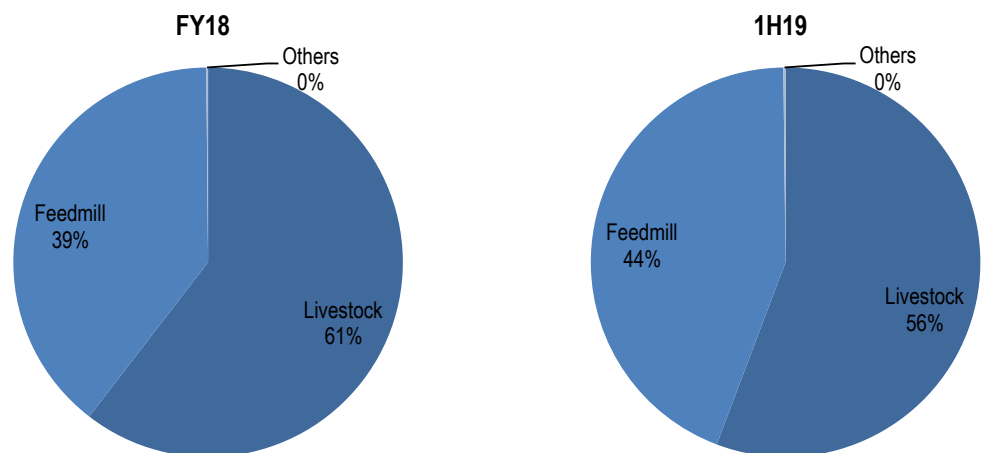
**Indonesia.** LHI conducts its livestock business in Indonesia through Malindo Group, which business operations in Indonesia can be broken down into 3 segments, namely (i) chicken production, (ii) egg production, and (iii) duck production. As at 31 Dec 2017, the Malindo Group had a domestic market share of 7% by annual supply of DOCs. All the broiler chicken that the Malindo Group produces is sold to external third parties, as it does not have slaughtering plant for broiler chicken in Indonesia. With regards to its food processing operations, the Malindo Group markets its processed food products under brands such as “Sunny Gold”, “Ciki Wiki”, and “Sobat” to hypermarkets. The Malindo Group operates two layer DOC farms and a layer chicken farm in Indonesia, which have housing capacities of 172.2k layer DOCs and 288k layer chickens. In FY17, the Malindo Group supplied 12.6m layer DOC, and produced 55.6m eggs. The Malindo Group sells all its eggs as table eggs within Indonesia.

**Vietnam.** LHI has been operating in Vietnam for 11 years and it is the second largest integrated producer in Vietnam by annual supply of DOCs, with a domestic market share of 13% in FY17. All the broiler chicken is sold to external third parties. As for egg production, LHI operates a layer DOC farm and three layer chicken farms in Vietnam. Including the 39 contract farms it utilises, it has housing capacities of 40k layer DOCs and 1.97m layer chickens. In FY17, LHI supplied 2.97m layer DOCs, and produced 389m eggs in Vietnam. All eggs produced are sold in Vietnam.

**Singapore.** LHI's livestock business operations in Singapore can be broken down into 3 segments, namely (i) chicken production, (ii) duck, and (iii) trading and storage. LHI's livestock business in Singapore owns several farms in Malaysia (due to the high land costs in Singapore). LHI's livestock business in Singapore focuses primarily on the slaughtering and distribution of broiler chicken, with a domestic market share of 45.3% (based on number of live chickens imported from Malaysia) as at 31 Dec 2017. As for the food processing operations, LHI markets its processed products under brand including "Sunny Gold" and "SAFA". LHI also sells some broiler DOCS and live broiler chicken directly from farms in Malaysia to third parties, and it delivers broiler chicken on a daily basis to over 450 locations in Singapore, which includes, amongst others, supermarkets, QSRs and other third-party purchasers. In FY17, LHI derived approximately 12% of the revenue of the Singapore livestock business from sales of broiler DOCS and live broiler chicken. Besides, LHI distributes frozen food products (including chicken, beef, lamb and seafood) to wholesalers located in Singapore.

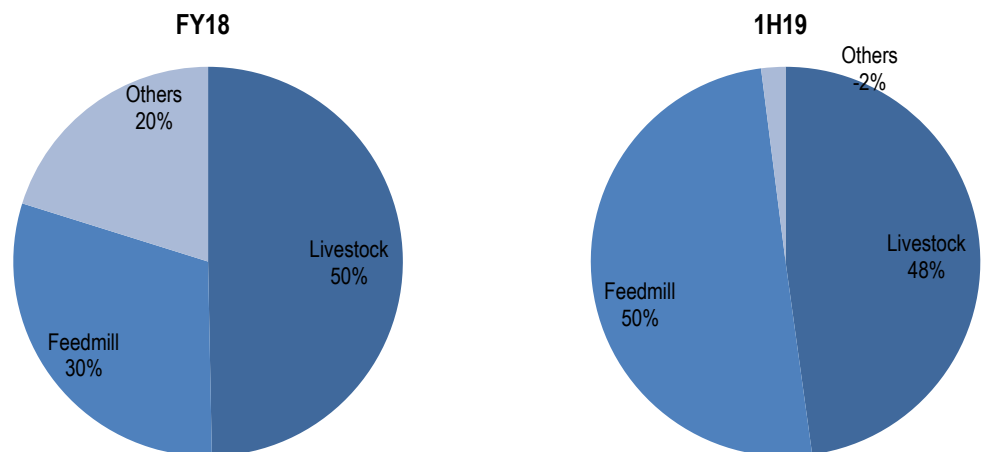
**Philippines.** LHI operates two PS DOC farms and two broiler chicken farms in the Philippines, and utilises 7 contract farms for housing broiler chicken. LHI's operations in the Philippines has been rather small *via-s-vis* other countries, as it is still a new market to LHI.

**Figure #3 Segmental revenue breakdown**



LHI; HLIB

**Figure #4 Segmental EBITDA breakdown**



LHI; HLIB

## Investment Highlights

Our investment highlights for LHI include:

1. LHI's exposure in the Southeast Asia region, which allows the group to capture the demand potential for poultry in the region;
2. Ongoing expansion plans in countries where it operates, which will result in higher production capacity and improve efficiency, hence strengthening LHI's foothold in the SEA market;
3. Low feed prices, which augur well for livestock business' production cost;
4. LHI's strong economies of scale thanks to its lion share in the region's poultry and poultry-related market;
5. LHI's fully-integrated business model, which gives LHI significant competitive advantage over other non-integrated players in terms of operating flexibility and resilience; and
6. Seasoned management team.

### Operating in fast-growing ASEAN consumer markets with rising poultry consumption

LHI operates in Southeast Asia with significant growth potential, underpinned by (i) favourable age demographic and growing population, (ii) increasing affluence and disposable income, and (iii) significant growth potential in the consumption of proteins, especially poultry.

**Favourable age demographic and growing population.** IMF projects population in the five countries where LHI operates (namely Malaysia, Indonesia, Singapore, Vietnam and Philippines) to grow from 498.6m in 2017 to 519.3m by 2020. In terms of age profile, the average of population in these five countries are young relative to the population in advanced economies (see Figures 5-6). Population growth and young age demographic will drive disposable income in these countries, which will in turn translate to higher discretionary buying power.

**Figure #5** Population in selected ASEAN countries, 2017 – 2020F

	Indonesia	Malaysia	Philippines	Singapore	Vietnam
Population (m) in 2017	262.0	32.1	105.3	5.6	93.6
CAGR (2017 – 2020F)	1.3%	1.3%	2.0%	0.9%	1.0%
Average age (2017E)	30.2	28.5	23.5	34.6	30.5

*IMF, World Economic Outlook (WEO) Apr 2018, Central Intelligence Agency, Frost & Sullivan, LHI exposure prospectus*

**Figure #6** Population and average age in ASEAN and selected markets, 2017 – 2020F

	US	EU	Japan	China	ASEAN
Population (m) in 2017	325.9	509.6	126.7	1,390.1	643.5
CAGR (2017 – 2020F)	0.8%	0.2%	-0.3%	0.5%	1.2%
Average age (2017E)	38.1	42.9	47.3	37.4	28.8

*IMF, World Economic Outlook (WEO) Apr 2018, Central Intelligence Agency, Frost & Sullivan, LHI exposure prospectus*

**Growing affluence and low per capita protein consumption.** IMF projects favourable economic growth in the five countries where LHI operates, and this will lead to disposable income growth. Higher disposable income will lead to growing affluence (from a low base) of the consumer groups, and this will in turn, drive protein consumption growth in Southeast Asia, as per capita protein consumption is still low in most of the countries where LHI operates (see Figure #7), which in turn bodes well for protein consumption prospects.

**Figure #7 Poultry meat consumption per capita**

Poultry meat consumption per capita (kg)				CAGR	CAGR	Total meat consumption per capita
	2012	2017E	2020F	2012 - 2017E	2017E - 2020F	2017E
US	44.4	48.8	48.1	1.9%	-0.5%	98.6
OECD	27.2	30.2	30.4	2.1%	20.0%	69.7
EU	21.4	24.2	24.8	2.5%	80.0%	69.6
Japan	13.1	14.3	14.5	1.8%	50.0%	36.4
World	13.2	13.9	13.9	1.0%	0.0%	34.4
China	11.7	12.3	12.7	1.0%	1.1%	50.2
<b>ID, MY, PH, SG, VN</b>	<b>12.0</b>	<b>15.2</b>	<b>17.7</b>	<b>4.8%</b>	<b>5.2%</b>	<b>28.2</b>
Developing Asia	7.9	8.4	8.7	1.2%	1.2%	26.0

Note: Developing Asia includes Bangladesh, China, India, Indonesia, Iran, Korea, Malaysia, Pakistan, the Philippines, Saudi Arabia, Thailand, Turkey and Vietnam

OECD; AVA (Singapore); Frost & Sullivan Analysis; LHI

**Poultry meat is preferred.** Poultry (in particular, chicken) is the preferred animal-based protein in the Southeast Asia region, given its relative affordability and quality (it is cheaper and more efficient to produce high quality poultry relative to other types of animal-based proteins), religious neutrality (as most religious dietary requirements do not prohibit chicken consumption), and the increasing penetration and popularity of quick service restaurants (QSRs). Religion aside, chicken also benefits from the trend of higher consumption of white meat instead of red meat due to perceived health benefits and affordability.

### Ongoing expansion plans to further strengthen LHI's presence in SEA region

Having spent total capex of circa RM1.5bn between FY15 and FY18, LHI is still in expansion mode in the near future (of which it has planned capex of RM437m in FY19) in order to strengthen its presence in the SEA region (in particularly, the 5 markets it operates in).

Among the 5 countries LHI operates in, Malaysia and Singapore are the most developed markets, where LHI has established strong leadership positions in each of the feedmill and livestock segments over the years. Within these markets, LHI intends to grow its operations through (i) continuous automation of its feedmills and farms, and replacing remaining open-house farms with closed-house farms, which will reduce its operating costs (in particularly, labour cost) and improve efficiency and output in Malaysia, (ii) integration and expansion of downstream food processing operations between Malaysia and Singapore, (iii) reduction of reliance on contract farms in Malaysia by investing in increasing the capacity and efficiency of its broiler farm operations, in order to have better control over the entire value chain and flexibility; and (iv) acquisition of other poultry producers or feedmills on an opportunistic basis in order to remain at the forefront of the industry consolidation.

LHI also intends to replicate its business model in the newer markets (i.e. Vietnam and Philippines), by expanding its upstream capacities in these markets in order to achieve better economies of scale and capture the growing demand potential there.

Existing markets aside, LHI is exploring Cambodian market through livestock imports, and may enter production there in the future when it sees sufficient demand from local customers.

**Figure #8** Progress on expansion plan

Location	Project	Commence ment date	Target completion date	Total investment
Philippines	Construction of new hatchery	4Q18	3Q19	RM8.5m
Vietnam	Construction of a spent grain drying facility at Dong Nai feedmill	1Q19	3Q19	RM1.6m
Philippines	Purchase of new ERP system	1Q19	4Q19	RM6.4m
Malaysia	Expansion of closed-house broiler farms	1Q19	4Q20	RM86.8m
Vietnam	Construction of additional 3 parent stock closed-house farms and machinery at Dong Nai farm	3Q19	4Q19	RM0.9m
Vietnam	Third pelleting line at Dong Nai feedmill	3Q19	4Q19	RM2.6m
Vietnam	Installation of automatic bagging & robotic pelletiser at Tien Giang feedmill	4Q19	4Q19	RM4.6m

LHI

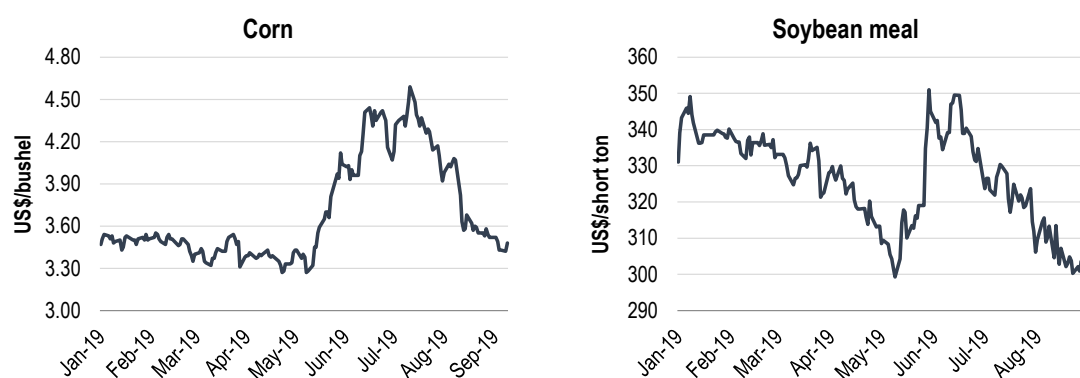
### Lower feed prices – a boon to livestock production cost

The primary raw materials for LHI's feedmill business are corn and soybean meal. Except for Indonesia (where domestically produced corn is used), LHI imports bulk of its raw materials. While profitability of the feedmill business is generally unaffected by movement of corn and soybean meal prices (as feed prices usually move in tandem with raw material prices), the movement in corn and soybean meal prices have an impact on profitability of livestock business (as livestock prices do not move in tandem with feed prices). Based on our estimate, feed prices are the second largest variable component in LHI's livestock business.

We note that prices of both corn and soybean meal have eased since Jul-19 (see Figure #9), as (i) weather concerns in US (the world's largest corn producer) eased, which has in turn resulted in corn prices trending downwards, and (ii) demand concerns arising from African Swine Flu (ASF) outbreak and trade escalations.

The Food and Agricultural Policy Research Institute (FAPRI) forecasts grain prices (including soybean and corn) to remain low in the near to medium term (2019-2020) on the back of ASF outbreak (which will result in Chinese hog herd declining by 20% in 2019 and another 10% in 2020, hence dragging consumption of soybean meal) and trade disputes.

We note that lower feed prices augur well for livestock production cost, as feed is the main cost component in producing livestock.

**Figure #9** Corn and soybean meal price movements

Bloomberg

### Strong economies of scale given its lion share in the region's poultry market

LHI is the largest integrated poultry producer in Malaysia and among the top 3 integrated producers in Indonesia and Vietnam, with an annual production of over 495.6m DOCs, 99.1m broiler chicken, approximately 2m MT of livestock feeds and over 1.7bn eggs in FY17. The sheer production size gives LHI an advantage over smaller competitors in the sourcing of raw materials, production and distribution of poultry and livestock feeds.



### **Fully-integrated business model**

LHI's operations are fully integrated, in terms of both value chain and geographic spread across Southeast Asia, and this provides LHI with significant competitive advantage over other non-integrated players in terms of operating flexibility and resilience. LHI's presence across the entire poultry production value chain provides the group with flexibility to adjust its sales mix at any stage in the production process in order to optimise profitability, and this is particularly important as poultry producers are generally price takers and are exposed to constant market price fluctuations within a commoditised industry.

### **Experienced management team**

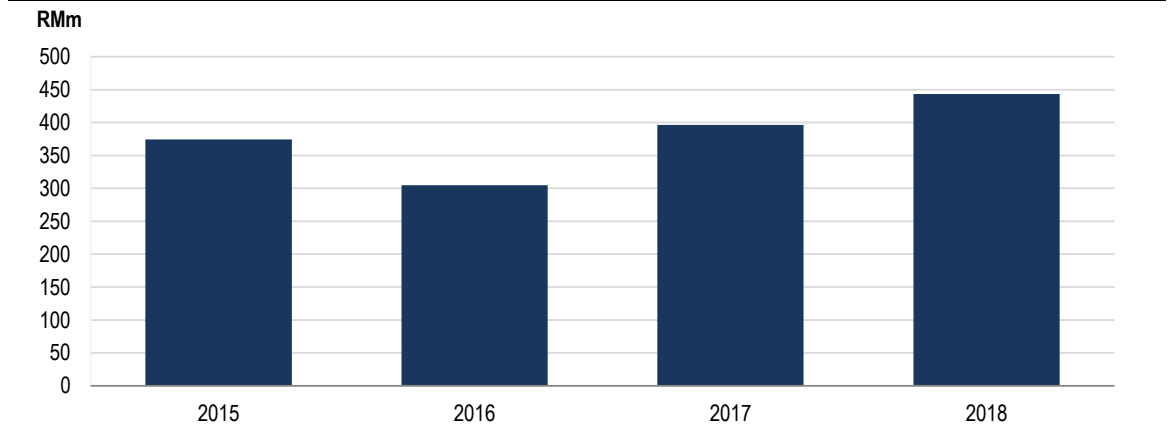
LHI's operations are led by seasoned management team and board of directors, of which some of them have over 30 years of experience in the poultry industry, which give them extensive know-how in operations, biology and genetics, and market mechanics in countries where they operate. The operational expertise (coupled with the security of access to high-end genetics) gives LHI a competitive advantage in the poultry industry.

# Financials

## Balance sheet

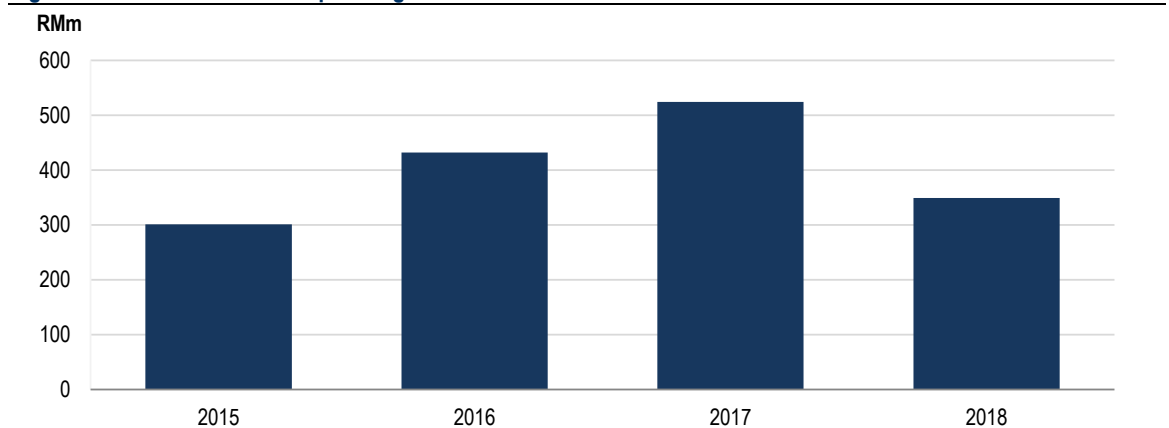
**Net gearing of 71.8% as at 30 Jun 2019.** Despite having incurred considerable amount of capex (RM300-400m p.a. since FY15, see Figure #10), LHI's net gearing ratio was relatively stable from 71.5% in FY15 to 71.8% in end-2Q19, due mainly to its ability to generate decent operating cash flow (RM300-525m p.a. since FY15, see Figure #11), and IPO proceeds of circa RM270m in 1H19. We project LHI's net gearing to decline further to 71.6%, 62.6% and 52.5%, respectively, in FY19-21 (see Figure #12), as the operating cash flow is more than sufficient to fund for LHI's capex and dividend payment.

**Figure #10 Historical capex**



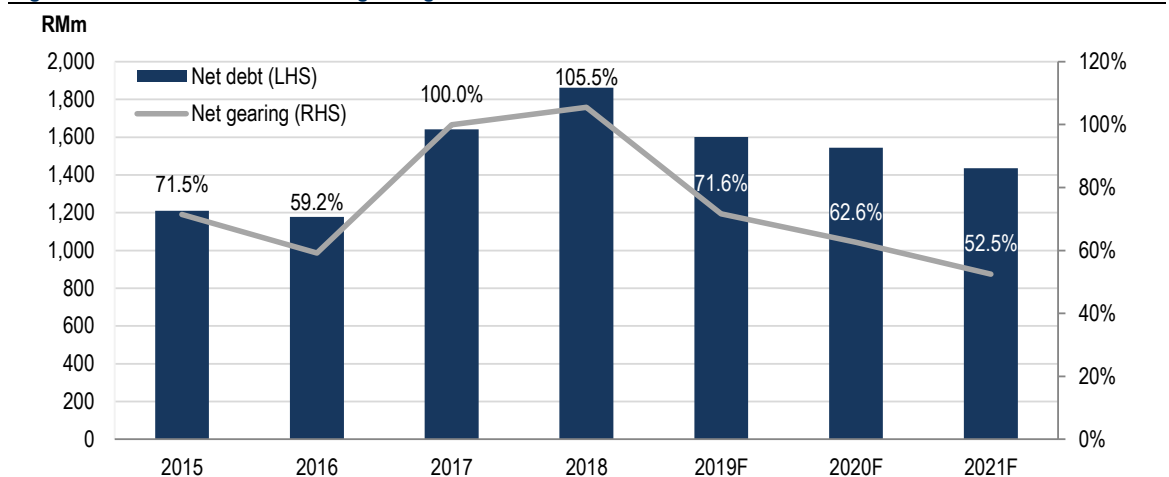
LHI; HLIB Research

**Figure #11 Historical operating cash flow**



LHI; HLIB Research

**Figure #12 Net debt & net gearing trend**



LHI; HLIB Research

**Dividend policy – 30% of net profit**

LHI is targeting a payout ratio of approximately 30% of its net profit (after taking into account of working capital and maintenance capital requirements).

**1H19 results review**

LHI's core net profit declined by 35.6% to RM81.9m, dragged mainly by weaker 2Q19 performance arising depressed livestock prices in Malaysia and Indonesia, as well as lower egg prices in Vietnam. The weaker livestock prices were, however, partly mitigated by increased in sales volume and selling prices of livestock feed in Indonesia and Vietnam (which Dong Nai feedmill plant had commenced operation since Jan-19).

**Figure #13 Results summary**

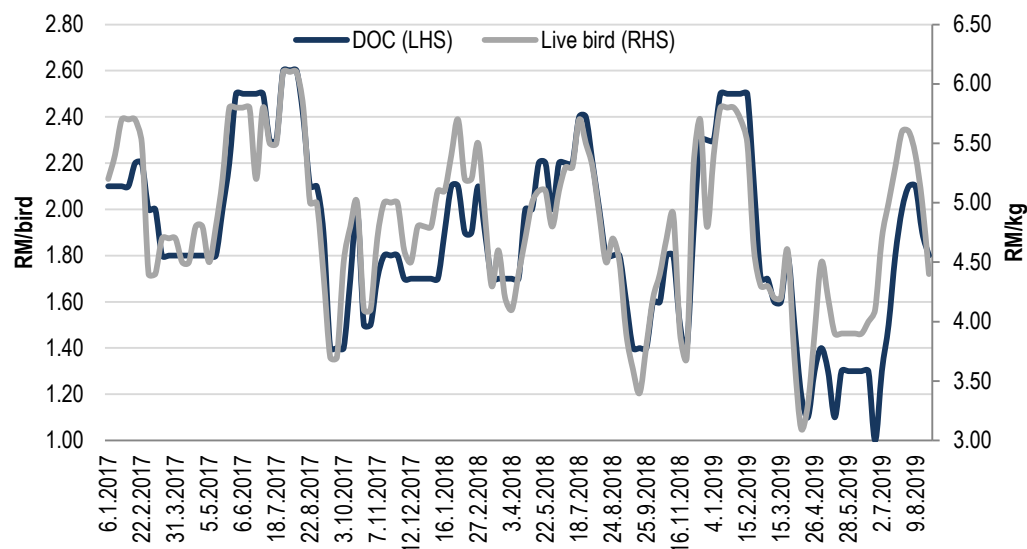
FY Dec (RMm)	2Q18	1Q19	2Q19	QoQ (%)	YoY (%)	1H18	1H19	YoY (%)
Revenue	1,423.1	1,506.4	1,477.2	-1.9	3.8	2,769.5	2,983.6	7.7
- Livestock & poultry related	910.7	859.7	803.7	-6.5	-11.8	1,747.9	1,663.3	-4.8
- Feedmill	506.4	643.6	671.3	4.3	32.6	1,013.1	1,314.9	29.8
- Others	6.0	3.1	2.3	-26.2	-61.7	8.5	5.4	-36.6
EBITDA	176.4	200.6	129.8	-35.3	-26.4	327.2	330.4	1.0
- Livestock & poultry related	129.6	118.9	45.7	-61.6	-64.7	224.1	164.6	-26.5
- Feedmill	48.3	85.2	87.6	2.8	81.4	110.8	172.7	55.9
- Others	-1.5	-3.5	-3.5	-1.1	129.8	-7.6	-6.9	-9.1
Profit from operations	127.5	147.7	74.7	-49.4	-41.4	229.3	222.4	-3.0
- Livestock & poultry related	93.6	79.1	4.5	-94.3	-95.2	150.3	83.6	-44.4
- Feedmill	37.9	73.0	74.6	2.2	97.0	89.0	147.6	65.8
- Others	-4.0	-4.4	-4.4	0.1	8.5	-10.0	-8.7	-13.2
Finance costs	-24.9	-32.9	-35.0	6.5	40.6	-49.4	-67.9	37.4
Associates	0.1	0.0	0.1	>100	18.8	0.2	0.2	-22.7
PBT	102.7	114.9	39.9	-65.3	-61.2	180.1	154.8	-14.1
Tax expense	-27.9	-24.6	-13.3	-46.0	-52.4	-44.3	-37.9	-14.5
PAT	74.8	90.3	26.6	-70.6	-64.5	135.8	116.8	-14.0
Non-controlling interests	-9.1	-29.7	-10.5	-	-	-17.5	-40.2	-
Reported net profit	65.7	60.6	16.1	-73.4	-75.5	118.3	76.7	-35.2
Core net profit	74.2	60.1	21.4	-64.4	-71.2	127.2	81.9	-35.6
Core EPS (sen)	2.0	1.6	0.6	-64.4	-71.2	3.5	2.2	-35.6
				<u>%-pts</u>	<u>%-pts</u>			<u>%-pts</u>
EBITDA margin (%)	12.4	13.3	8.8	-4.5	-3.6	11.8	11.1	-0.7
Operating margin (%)	9.0	9.8	5.1	-4.7	-3.9	8.3	7.5	-0.8
PBT margin (%)	7.2	7.6	2.7	-4.9	-4.5	6.5	5.2	-1.3
Net margin (%)	5.2	4.0	1.4	-2.5	-3.8	4.6	2.7	-1.8

Exceptional items in 2Q19 include: (i) RM3.2m impairment loss on receivables, (ii) RM93k disposal gain, and (iii) RM2.08m share option expense

LHI; HLIB Research

... **anticipating better 2H19.** For FY19, we project a core net profit of RM194.2m (-11.6% YoY), as we expect LHI's performance to recover in 2H19, underpinned by a recovery in livestock prices in Malaysia and Indonesia, and higher livestock and feedmill sales volume.

**Beyond FY19...** We project FY20-21 core net profit to increase by 15.1-15.2% to RM233.5m and RM257.5m, underpinned by higher livestock and feedmill sales volume (arising from capacity expansion).

**Figure #14** Weekly price trend for DOC and live bird in Malaysia

DVS; HLIB Research

## Valuations

At current share price of RM0.805, LHI is trading at FY19-21 P/E of 15.1x, 13.1x and 11.4x, respectively. We believe the weak 2Q19 performance has already been reflected in recent share price performance (which plunged to a low of 34.5% since IPO listing before recently rebounding by 11.8%), and we expect LHI's performance to recover considerably in 2H19, underpinned by (i) A strong recovery in broiler and DOC prices in Malaysia and Indonesia; and (ii) Higher capacity at both feedmill and livestock segments.

We initiate coverage on LHI with a **BUY** rating and TP of RM1.10 based on 18x FY20 EPS of 6.1 sen. Our target P/E of 18x is arrived based on 10% discount to the major poultry players in SEA region, to reflect LHI's smaller market capitalisation relative to regional market players.

**Figure #15** Peers comparison

	Mkt Cap US\$m	EV US\$m	P/E (x)			EV/EBITDA (x)			P/B (x)		
			2018	2019	2020	2018	2019	2020	2018	2019	2020
<b>Malaysia peers</b>											
QL Resources	2,754	2,925	50.6	46.2	41.5	27.2	24.2	22.5	5.4	5.1	4.7
CCK Consolidated	76	80	11.0	11.3	9.6	6.0	5.6	5.2	1.2	1.1	1.0
<b>Thailand peers</b>											
Charoen Pokphand Foods PCL	8,292	17,991	40.2	16.7	15.1	18.6	11.7	11.7	1.3	1.2	1.2
<b>Indonesia peers</b>											
Charoen Pokphand Indonesia	10,697	11,200	19.3	24.4	20.7	13.4	12.6	11.2	4.7	4.0	3.5
Japfa Comfeed Indonesia	1,267	1,564	8.7	10.6	9.4	6.0	5.3	4.8	1.7	1.5	1.3
Malindo Feedmill	142	142	9.0	7.9	6.8	3.4	3.1	2.7	1.0	0.9	0.9
<b>Philippine peers</b>											
San Miguel Food & Beverage	9,985	10,011	28.4	29.0	25.2	15.4	8.5	7.7	4.0	2.1	2.0

Bloomberg; HLIB Research

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<b>HOLD</b>	Expected absolute return of -10% to +10% over the next 12 months.
<b>SELL</b>	Expected absolute return of -10% or less over the next 12 months.
<b>UNDER REVIEW</b>	Rating on the stock is temporarily under review which may or may not result to a change from the previous rating.
<b>NOT RATED</b>	Stock is not or no longer within regular coverage.

**Sector rating guidelines**

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