

27 November 2019

Poultry | Food & Beverages Product

Leong Hup International (LHIB MK)

Buy (Maintained)

Sharp QoQ Rebound; Stay BUY

| | |
|------------------------------|----------------|
| Target Price (Return) | MYR1.26 (+40%) |
| Price: | MYR0.90 |
| Market Cap: | USD778m |
| Avg Daily Turnover (MYR/USD) | 3.94m/0.94m |

- Maintain BUY with lower TP of MYR1.26 from MYR1.36, offering 40% upside, 1.6% FY19F yield.** LHI's 9M19 results missed expectations mainly due to depressed product prices in Indonesia. 4Q19 could see sustained earnings momentum given the price recovery in Indonesia, although Malaysia has started to see normalisation from the strong price recovery in 3Q19. Over the longer run, sustainable growth would be underpinned by capacity expansion and robust consumption of poultry products.
- 9M19 results below expectations.** Leong Hup International's (LHI) 9M19 core net profit of MYR124.9m (-23.5% YoY) trailed both our and consensus' expectations after accounting for only 62% of estimates. The negative deviation is attributed to the weaker-than-expected product prices, particularly in Indonesia.
- Post results, we trim FY19-21 earnings forecasts** by 7.5-14.3% after imputing more realistic assumptions on product prices. Correspondingly, our DCF-driven TP is revised down to MYR1.26 from MYR1.36 previously as we also take the opportunity to update our DCF assumptions. Our TP implies 20x P/E FY20F, which is in line with the regional peer average.
- Results review.** YoY, 9M19 revenue grew 7.6% to MYR4.5bn primarily driven by solid growth in Indonesia and Vietnam markets on the back of capacity expansion and higher sales volume. However, 9M19 EBITDA margin slipped by 0.3ppt to 11.2%, mainly dragged down by depressed product prices – particularly in Indonesia. Dissecting the numbers by segment, revenue and EBITDA contribution from the feedmill business jumped 22.4% and 72.6% respectively, thanks to capacity expansion and favourable product prices. This partially offset the weakness in the livestock business, which was affected by weak product prices.
- Momentum could sustain into 4Q19.** LHI's share price has staged a rebound as the market prices in a sharp QoQ recovery in 3Q19. We note that 4Q19 broiler and day-old chicks (DOC) prices have started to soften QoQ in Malaysia probably due to the wet weather, whereas in Indonesia, product prices have begun to strengthen. Together with the ongoing expansion and pick-up in utilisation rate, 4Q19 earnings could sustain the positive momentum. Nonetheless, we highlight the short-term price fluctuations inherent in the poultry industry and emphasise that investors should instead be focused on the longer-term growth prospects of the company. This would be underpinned by capacity expansion across operating markets and the robust consumption of poultry products as the cheapest source of protein and its religious neutrality.
- Risks to our recommendation** include unfavourable changes in regulatory policy and supply-demand dynamics.

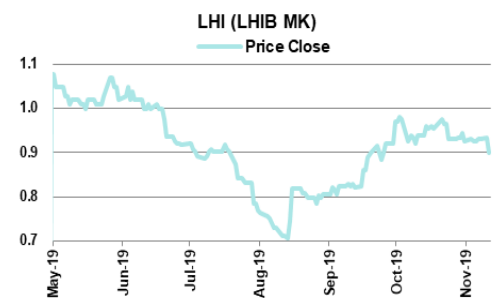
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Share Performance (%)

| | YTD | 1m | 3m | 6m | 12m |
|----------------------------|-----|-------|------|-------------|-----|
| Absolute | NA | (4.3) | 24.1 | (13.5) | NA |
| Relative | NA | (5.1) | 25.2 | (12.6) | NA |
| 52-wk Price low/high (MYR) | | | | 0.72 - 1.19 | |



Source: Bloomberg

| Forecasts and Valuation | Dec-17 | Dec-18 | Dec-19F | Dec-20F | Dec-21F |
|------------------------------|--------|--------|---------|---------|---------|
| Total turnover (MYRm) | 5501.4 | 5746.6 | 6001.9 | 6435.0 | 7036.9 |
| Net profit (MYRm) | 185.0 | 219.0 | 174.0 | 225.7 | 273.3 |
| Net profit growth (%) | (18.1) | 18.4 | (20.6) | 29.7 | 21.1 |
| Recurring EPS (MYR) | 0.05 | 0.06 | 0.05 | 0.06 | 0.07 |
| Recurring P/E (x) | 17.8 | 15.0 | 18.9 | 14.6 | 12.0 |
| P/B (x) | 2.8 | 2.5 | 1.9 | 1.8 | 1.6 |
| P/CF (x) | 6.3 | 9.4 | 7.3 | 6.5 | 6.0 |
| Dividend Yield (%) | 1.2 | 1.8 | 1.6 | 2.1 | 2.5 |
| EV/EBITDA (x) | 9.2 | 8.6 | 8.5 | 7.5 | 6.7 |
| Return on average equity (%) | 15.4 | 17.6 | 11.6 | 12.7 | 14.0 |
| Net debt to equity (%) | 99.8 | 108.3 | 83.8 | 83.9 | 100.5 |

Source: Company data, RHB

Financial Exhibits

| | | | | | | | |
|---|-------|-------------------------------------|---------------|---------------|----------------|----------------|----------------|
| Asia | | Financial summary | Dec-17 | Dec-18 | Dec-19F | Dec-20F | Dec-21F |
| Malaysia | | Recurring EPS (MYR) | 0.05 | 0.06 | 0.05 | 0.06 | 0.07 |
| Consumer Poultry | | DPS (MYR) | 0.01 | 0.02 | 0.01 | 0.02 | 0.02 |
| Leong Hup International | | BVPS (MYR) | 0.32 | 0.36 | 0.47 | 0.51 | 0.56 |
| | | ROE (%) | 15.4 | 17.6 | 11.5 | 12.7 | 14.0 |
| Major shareholders (%) | | Valuation metrics | Dec-17 | Dec-18 | Dec-19F | Dec-20F | Dec-21F |
| Emerging Glory | 52.80 | Recurring P/E (x) | 17.8 | 15.0 | 19.1 | 14.6 | 12.0 |
| Lau Family | 9.70 | P/B (x) | 2.8 | 2.5 | 1.9 | 1.8 | 1.6 |
| Clarinden Investments | 7.96 | FCF Yield (%) | 6.1 | 0.9 | 1.9 | 4.2 | 6.0 |
| Valuation basis | | Dividend yield (%) | 1.2 | 1.8 | 1.6 | 2.1 | 2.5 |
| Discounted cash flow | | EV/EBITDA (x) | 9.2 | 8.6 | 8.5 | 7.5 | 6.7 |
| | | EV/EBIT (x) | 14.0 | 12.4 | 13.1 | 11.4 | 10.1 |
| Key drivers | | Income statement (MYRm) | Dec-17 | Dec-18 | Dec-19F | Dec-20F | Dec-21F |
| i. Regional expansion plan; | | Total turnover | 5,501 | 5,747 | 6,002 | 6,435 | 7,037 |
| ii. Favourable product prices. | | Gross profit | 913 | 1,034 | 1,008 | 1,101 | 1,206 |
| | | EBITDA | 583 | 655 | 652 | 757 | 863 |
| Key risks | | Depreciation and amortisation | (199) | (197) | (227) | (256) | (287) |
| i. Unfavourable change in regulatory policy; | | Operating profit | 384 | 457 | 426 | 501 | 576 |
| ii. Unfavourable demand-supply dynamics. | | Interest expenses | (103) | (92) | (109) | (121) | (121) |
| | | Income from associates & JVs | 0 | 1 | 1 | 1 | 1 |
| Company Profile | | Pre-tax profit | 292 | 349 | 305 | 380 | 448 |
| LHI is on one of the largest fully-integrated producers of poultry, eggs, and livestock feeds in South-East Asia. | | Taxation | (45) | (102) | (67) | (84) | (99) |
| | | Recurring net profit | 185 | 219 | 172 | 226 | 273 |
| | | Cash flow (MYRm) | Dec-17 | Dec-18 | Dec-19F | Dec-20F | Dec-21F |
| | | Change in working capital | 11 | (242) | (74) | (98) | (140) |
| | | Cash flow from operations | 524 | 349 | 446 | 505 | 548 |
| | | Capex | (368) | (423) | (450) | (450) | (450) |
| | | Cash flow from investing activities | (367) | (379) | (450) | (450) | (450) |
| | | Proceeds from issue of shares | - | - | 275 | - | - |
| | | Dividend paid | (58) | (66) | (52) | (68) | (82) |
| | | Cash flow from financing activities | (72) | (7) | (19) | (39) | (109) |
| | | Cash at beginning of period | 413 | 502 | 459 | 436 | 453 |
| | | Net change in cash | 86 | (36) | (22) | 16 | (12) |
| | | Ending cash balance | 502 | 459 | 436 | 453 | 441 |
| | | Balance sheet (MYRm) | Dec-17 | Dec-18 | Dec-19F | Dec-20F | Dec-21F |
| | | Total cash and equivalents | 502 | 459 | 436 | 453 | 441 |
| | | Tangible fixed assets | 2,046 | 2,374 | 2,598 | 2,792 | 2,955 |
| | | Total investments | 164 | 22 | 22 | 22 | 22 |
| | | Total assets | 4,477 | 4,834 | 5,120 | 5,445 | 5,763 |
| | | Short-term debt | 1,399 | 1,327 | 1,250 | 1,400 | 1,500 |
| | | Total long-term debt | 742 | 1,044 | 1,000 | 1,000 | 1,000 |
| | | Total liabilities | 2,835 | 3,069 | 2,959 | 3,126 | 3,252 |
| | | Total equity | 1,186 | 1,302 | 1,697 | 1,855 | 2,047 |
| | | Net debt | 1,638 | 1,912 | 1,814 | 1,947 | 2,059 |
| | | Total liabilities & equity | 4477 | 4834 | 5120 | 5445 | 5763 |
| | | Key metrics | Dec-17 | Dec-18 | Dec-19F | Dec-20F | Dec-21F |
| | | Revenue growth (%) | 4.6 | 4.5 | 4.4 | 7.2 | 9.4 |
| | | Recurring EPS growth (%) | (18.1) | 18.4 | (21.3) | 30.9 | 21.1 |
| | | Gross margin (%) | 16.6 | 18.0 | 16.8 | 17.1 | 17.1 |
| | | Ebitda margin (%) | 10.6 | 11.4 | 10.9 | 11.8 | 12.3 |
| | | Operating margin (%) | 7.0 | 8.0 | 7.1 | 7.8 | 8.2 |
| | | Recurring net profit margin (%) | 3.4 | 3.8 | 2.9 | 3.5 | 3.9 |
| | | Capex/sales (%) | 6.7 | 7.4 | 7.5 | 7.0 | 6.4 |
| | | Interest cover (x) | 4.2 | 4.2 | 3.5 | 4.1 | 4.5 |

Source: Company data, RHB

Results At a Glance

Figure 1: LHI's results review

| FYE Dec (MYRm) | 3Q18 | 2Q19 | 3Q19 | QoQ (%) | YoY (%) | 9M18 | 9M19 | YoY (%) | Comments |
|-------------------------------|----------------|----------------|----------------|--------------|-------------|----------------|----------------|---------------|--|
| Revenue | 1,422.5 | 1,477.2 | 1,527.1 | 3.4 | 7.4 | 4,192.0 | 4,510.7 | 7.6 | Robust growth in most of the operating countries |
| EBITDA | 155.2 | 129.8 | 173.7 | 33.8 | 12.0 | 482.4 | 504.2 | 4.5 | Weaker showing particularly in Indonesia |
| <i>EBITDA margin (%)</i> | <i>10.9</i> | <i>8.8</i> | <i>11.4</i> | <i>2.6</i> | <i>0.5</i> | <i>11.5</i> | <i>11.2</i> | <i>(0.3)</i> | |
| EBIT | 106.4 | 74.7 | 118.3 | 58.4 | 11.2 | 335.7 | 340.8 | 1.5 | |
| <i>EBIT Margin (%)</i> | <i>7.5</i> | <i>5.1</i> | <i>7.7</i> | <i>2.7</i> | <i>0.3</i> | <i>8.0</i> | <i>7.6</i> | <i>(0.5)</i> | |
| Finance costs | (28.7) | (35.0) | (34.6) | (1.1) | 20.7 | (78.1) | (102.4) | 31.2 | |
| EI | 0.0 | 2.1 | 1.8 | nm | nm | 9.7 | 3.9 | nm | 9M18: write-off in Value Added Tax receivables, 9M19: share option expenses |
| Profit before tax | 77.9 | 39.9 | 83.8 | 110.3 | 7.6 | 258.1 | 238.6 | (7.5) | |
| <i>PBT Margin (%)</i> | <i>5.5</i> | <i>2.7</i> | <i>5.5</i> | <i>2.8</i> | <i>0.0</i> | <i>6.2</i> | <i>5.3</i> | <i>(0.9)</i> | |
| Tax expense | (22.2) | (13.3) | (21.5) | 61.4 | (3.5) | (66.6) | (59.4) | (10.8) | |
| <i>Effective tax rate (%)</i> | <i>(28.5)</i> | <i>(33.4)</i> | <i>(25.6)</i> | <i>7.8</i> | <i>2.9</i> | <i>(25.8)</i> | <i>(24.9)</i> | <i>0.9</i> | |
| Minority interests | (20.5) | (10.5) | (18.0) | nm | nm | (37.9) | (58.1) | nm | |
| PATAMI | 35.2 | 16.1 | 44.4 | 175.9 | 26.1 | 153.6 | 121.1 | (21.2) | |
| Core PATAMI | 35.2 | 18.2 | 46.2 | 154.3 | 31.2 | 163.3 | 124.9 | (23.5) | Below expectations at 62% of forecasts. |
| <i>Net Margin (%)</i> | <i>2.5</i> | <i>1.2</i> | <i>3.0</i> | <i>1.8</i> | <i>0.5</i> | <i>3.9</i> | <i>2.8</i> | <i>(1.1)</i> | |

Source: Company, RHB

Figure 2: LHI's geographical breakdown

| FYE Dec (MYRm) | 3Q18 | 2Q19 | 3Q19 | QoQ (%) | YoY (%) | 9M18 | 9M19 | YoY (%) | Comments |
|-------------------------|----------------|----------------|----------------|-------------|-------------|----------------|----------------|--------------|---|
| Malaysia | 390.6 | 368.0 | 426.3 | 15.8 | 9.1 | 1,211.4 | 1,236.6 | 2.1 | Higher selling price and volume of eggs |
| Singapore | 230.0 | 191.1 | 201.8 | 5.6 | (12.3) | 757.5 | 586.2 | (22.6) | Due to the disposal of a subsidiary |
| Vietnam | 288.1 | 335.2 | 344.4 | 2.8 | 19.5 | 806.6 | 972.8 | 20.6 | |
| Indonesia | 495.3 | 563.9 | 532.1 | (5.6) | 7.4 | 1,368.8 | 1,659.4 | 21.2 | |
| Philippines | 16.2 | 16.7 | 19.4 | 16.2 | 19.6 | 39.4 | 50.2 | 27.4 | |
| Group revenue | 1,422.5 | 1,477.2 | 1,527.1 | 3.4 | 7.4 | 4,192.0 | 4,510.7 | 7.6 | |
| Malaysia | 29.4 | 24.0 | 70.6 | 194.6 | 139.8 | 146.6 | 173.5 | 18.3 | |
| Singapore | 28.9 | 29.3 | 22.3 | (23.9) | (22.9) | 96.4 | 79.4 | (17.7) | |
| Vietnam | 25.2 | 29.1 | 30.2 | 4.0 | 19.8 | 75.2 | 88.4 | 17.5 | |
| Indonesia | 70.0 | 45.8 | 47.0 | 2.6 | (32.9) | 159.5 | 155.9 | (2.3) | Depressed product prices |
| Philippines | 1.6 | 1.7 | 3.7 | 110.7 | 130.1 | 4.6 | 7.1 | 53.3 | |
| Group EBITDA | 155.2 | 129.8 | 173.7 | 33.8 | 12.0 | 482.4 | 504.2 | 4.5 | |
| Malaysia | 7.5 | 6.5 | 16.6 | 10.0 | 9.0 | 12.1 | 14.0 | 1.9 | |
| Singapore | 12.6 | 15.3 | 11.0 | (4.3) | (1.5) | 12.7 | 13.5 | 0.8 | |
| Vietnam | 8.8 | 8.7 | 8.8 | 0.1 | 0.0 | 9.3 | 9.1 | (0.2) | |
| Indonesia | 14.1 | 8.1 | 8.8 | 0.7 | (5.3) | 11.7 | 9.4 | (2.3) | |
| Philippines | 9.8 | 10.4 | 18.8 | 8.5 | 9.0 | 11.8 | 14.2 | 2.4 | |
| Group margin (%) | 10.9 | 8.8 | 11.4 | 2.6 | 0.5 | 11.5 | 11.2 | (0.3) | |

Source: Company, RHB

Figure 3: LHI's segmental breakdown

| FYE Dec (MYRm) | 3Q18 | 2Q19 | 3Q19 | QoQ (%) | YoY (%) | 9M18 | 9M19 | YoY (%) | Comments |
|-------------------------|----------------|----------------|----------------|-------------|-------------|----------------|----------------|-------------|---|
| Livestock | 814.9 | 803.7 | 858.2 | 6.8 | 5.3 | 2,562.8 | 2,521.5 | -1.6 | Due to disposal of a subsidiary in Singapore |
| Feedmill | 605.3 | 671.3 | 665.8 | -0.8 | 10.0 | 1,618.4 | 1,980.7 | 22.4 | Driven by capacity expansion and higher pricing |
| Others | 2.3 | 2.3 | 3.1 | 37.2 | 36.7 | 10.8 | 8.5 | -21.0 | |
| Group revenue | 1,422.5 | 1,477.2 | 1,527.1 | 3.4 | 7.4 | 4,192.0 | 4,510.7 | 7.6 | |
| Livestock | 105.8 | 45.7 | 41.8 | -8.6 | -60.5 | 329.9 | 206.4 | -37.4 | Weak prices in Indonesia and Vietnam |
| Feedmill | 66.7 | 87.6 | 133.5 | 52.4 | 100.2 | 177.4 | 306.2 | 72.6 | |
| Others | -17.3 | -3.5 | -1.5 | -56.5 | -91.4 | -25.0 | -8.4 | -66.2 | |
| Group EBITDA | 155.2 | 129.8 | 173.7 | 33.8 | 12.0 | 482.4 | 504.2 | 4.5 | |
| Livestock | 13.0 | 5.7 | 4.9 | -0.8 | -8.1 | 12.9 | 8.2 | -4.7 | |
| Feedmill | 11.0 | 13.0 | 20.0 | 7.0 | 9.0 | 11.0 | 15.5 | 4.5 | |
| Group margin (%) | 10.9 | 8.8 | 11.4 | 2.6 | 0.5 | 11.5 | 11.2 | -0.3 | |

Source: Company, RHB

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| | |
|---------------------|--|
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