

Leong Hup International Bhd

TP: RM0.650 (+1.0%)
Scaling Back amid Challenging Operating Environment
Last Traded: RM0.645
Sell

Jeff Lye Zhen Xiong, CFA

Tel: +603-2167 9730

jefflye@ta.com.my

www.taonline.com.my

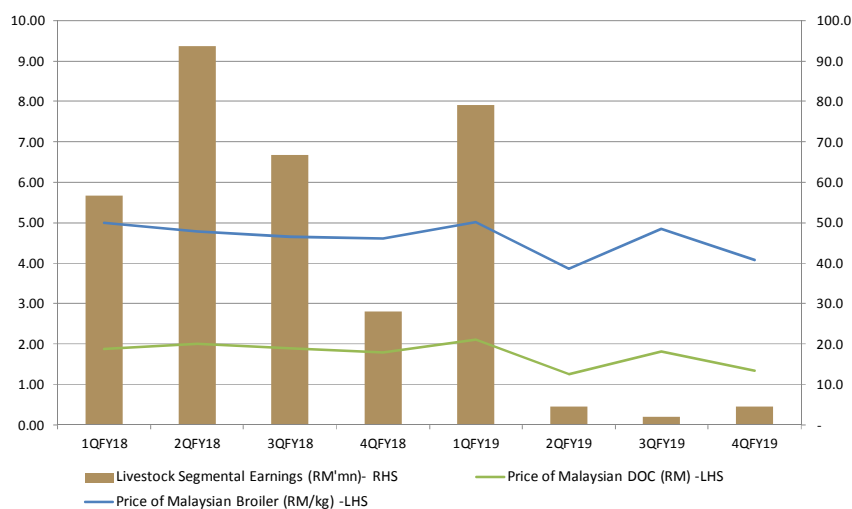
Amid Covid-19 outbreak, the operating environment of poultry industry is challenging due to declines in demand and ASP. Moreover, we expect LHI's future growth to be impacted by the scale backs in expansion projects. As such, we downgrade our recommendation to Sell with a lower target price of RM0.650/share.

Covid-19 Reduce Poultry's Demands and ASP

The impact of Covid-19 outbreak and implementation of country lockdown or movement control order (MCO) have reduced Leong Hup International's (LHI) poultry sales. The decline is attributed to closure of commercial businesses i.e. restaurants, canteens for schools, factories and hotels alongside absences of big-scale open house and corporate gathering. Meanwhile, the consumption of eggs, which represents c.15% of LHI's Livestock revenue, remains resilient as one of the favourite go-to products during the lockdown period. However, it is insufficient to mitigate the decline in sales of broilers and day-old-chicks (DOCs).

The decline in demand has resulted in some pricing pressure on poultry products. The pressure is further amplified by offloading activities from farmers to avoid massive write-offs. In 1H FY20, we expect a drop in average selling price (ASP) of broilers and DOCs to levels akin to 2QFY19 where Livestock EBIT earnings is minimal at RM4.5mn. Recall that, LHI's ASPs of DOCs and broilers were RM1.21/DOC and RM3.99/kg respectively in 2QFY19 versus 2014-2019 average of RM1.78/DOC and RM4.71/kg for Malaysian operations.

Figure 1: Historical Livestock Earnings Against Malaysian Livestock ASP



Source: TA Securities, Company

Share Information

Bloomberg Code	LHI MK
Stock Code	6633
Listing	Main Market
Share Cap (mn)	3650.0
Market Cap (RMmn)	2354.3
52-wk Hi/Lo (RM)	1.19/0.43
12-mth Avg Daily Vol ('000 shrs)	nm
Estimated Free Float (%)	25.68%-29.54%
Beta	nm
Major Shareholders (%)	
Emerging Glory	52.8%
Clarinden Investment	9.0%

Forecast Revision (%)

	FY20	FY21
Forecast Revision (%)	(26.1)	(14.3)
Net Profit (RM mn)	128.0	169.9
Consensus	170.4	202.0
TA/Consensus (%)	75.1	84.1
Previous Rating	Buy (Downgraded)	

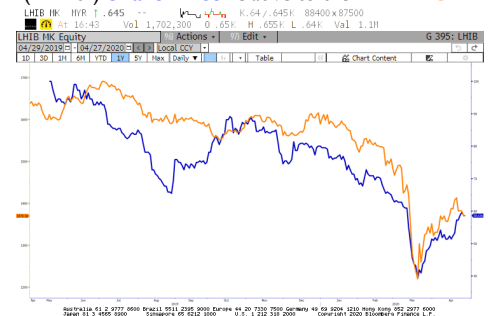
Financial Indicators

	FY20	FY21
Net debt/equity (%)	0.8	0.8
ROE (%)	7.6	9.5
ROA (%)	2.3	3.0
NTA/Share (RM)	0.4	0.5
Price/ NTA (x)	1.4	1.3

Share Performance

Price Change (%)	LHI	FBM KLCI
1 mth	21.7	2.0
3 mth	(17.8)	(11.7)
6 mth	(31.4)	(12.7)
12 mth	nm	(16.4)

(12-Mth) Share Price relative to the FBMKLCI



Source: Bloomberg

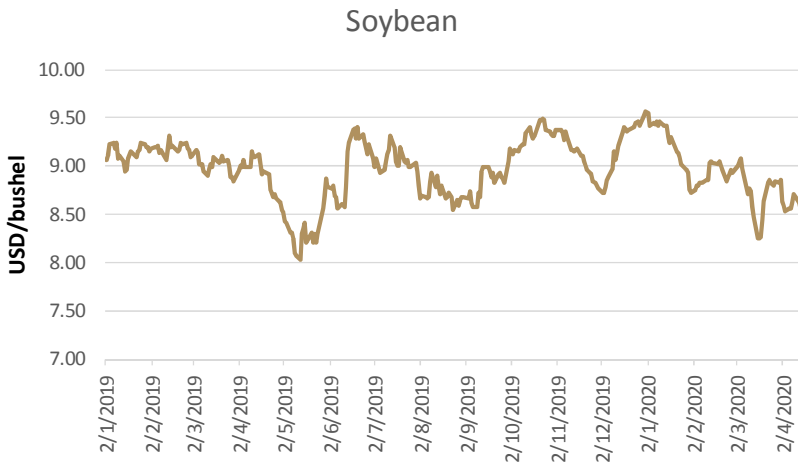
Delay in Capex Plan

We believe construction of on-going projects, i.e. construction of Philippine’s feedmill plant and farms as well as Vietnam’s Dong Nai additional pelleting lines, have been temporarily halted/disrupted due to lockdown. This is expected to delay commencement of these Livestock and Feedmill facilities, which are slated for completion by late-2020 originally. Looking forward, management shares that they would review and potentially scale down future projects to ensure optimal use of new capacity amid challenging operating environment.

Soft Commodities Render Some Help

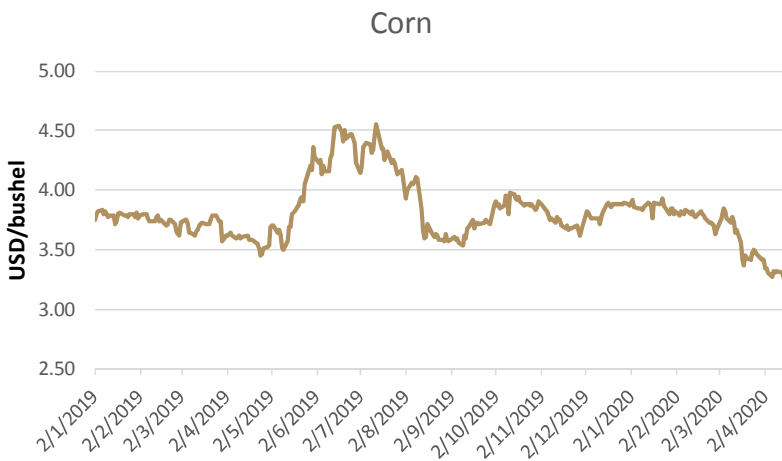
Jan-Apr 2020 CBOT soybean average price has dropped 2.2% YoY against previous corresponding period, while CBOT corn recorded 1.5% YoY decline against previous corresponding period. The low prices of soybean and corn may alleviate some pressure on margins from lower poultry ASP and sales, Soybean and corn are the core raw materials to poultry business, forming c.60% of the raw materials composition.

Figure 2: Price trend of Soybean



Source: Bloomberg, TA Securities

Figure 3: Price trend of Corn



Source: Bloomberg, TA Securities

Impact

We make following changes in assumptions:

- i) Cut our FY20 average ASP estimates for DOC and broiler by 5-7%. We also cut FY20/21/22 volume for DOC and broilers by 5-8% to 479/494/508mn and 118/127/132mn respectively.
- ii) Project low single digit YoY decline in our FY20 corn and soybean price assumptions.
- iii) Trim FY20/21/22 capex to RM350/400/367mn from RM450/450/397mn respectively.

As a result, FY20/21/22 earnings are reduced by 26/14/6% respectively.

Valuation

Following our recent upgrade of LHI's stock recommendation to Buy in late Mar-2020, LHI's share price has gained 22% as it recovered from earlier oversold position. At current price level, we believe weakness in upcoming 1Q and 2Q quarterly results due to weaker Livestock demands and ASP alongside expectation of a slower growth in future year would limit upside of total return. Therefore, we now advocate Sell to take profit on LHI with a lowered target price of RM0.650/share (previously: RM0.760/share) based on unchanged 14x FY21 EPS. Downgrade to Sell.

Earnings Summary

Profit and Loss Statement

FYE 31 Dec (RMmn)	2018	2019	2020E	2021F	2022F
Revenue	5,746.6	6,054.8	6,159.5	6,693.3	7,073.2
EBITDA	646.1	636.9	591.9	684.2	736.3
Depreciation	(197.1)	(225.5)	(247.4)	(261.1)	(270.7)
Net finance cost	(101.0)	(123.8)	(110.5)	(112.3)	(111.6)
Associate	0.6	0.4	0.4	0.5	0.5
EI	(22.9)	0.0	0.0	0.0	0.0
PBT	348.6	288.8	234.5	311.3	354.6
Taxation	(101.8)	(75.8)	(61.5)	(81.7)	(93.0)
MI	(60.6)	(62.4)	(45.0)	(59.7)	(68.0)
Net profit	186.2	150.6	128.0	169.9	193.5
Core net profit	215.2	150.6	128.0	169.9	193.5

Core EPS (sen)	5.9	4.1	3.5	4.7	5.3
Diluted EPS (sen)	5.9	4.1	3.5	4.7	5.3
DPS (sen)	0.0	1.6	1.1	1.4	1.6
Book Value (RM)	0.5	0.6	0.6	0.7	0.7
NTA (RM)	0.3	0.4	0.4	0.5	0.5

Ratios

FYE 31 Dec (RMmn)	2018	2019	2020E	2021F	2022F
Valuations					
Core PER (x)	10.9	15.5	18.3	13.8	12.1
Div. Yield (%)	0.0	2.5	1.6	2.2	2.5
P/BV (x)	1.3	1.1	1.0	0.9	0.9

Profitability ratios

EBITDA margin (%)	11.6	10.5	9.6	10.2	10.4
PBT margin (%)	6.5	4.8	3.8	4.7	5.0
Core Net Margin (%)	3.7	2.5	2.1	2.5	2.7
Core ROE (%)	17.3	10.2	7.6	9.5	10.1
Core ROA (%)	4.6	2.9	2.3	3.0	3.3

Liquidity ratios

Current ratio (x)	1.2	1.2	1.2	1.2	1.3
Quick ratio (x)	0.9	0.9	0.9	0.9	0.9

Leverage ratios

Equity/total liabilities (x)	0.6	0.7	0.7	0.8	0.8
Net debt / equity (x)	1.1	0.7	0.8	0.8	0.7

Growth ratios

Revenue (%)	4.5	5.4	1.7	8.7	5.7
PBT (%)	19.3	(17.2)	(18.8)	32.7	13.9
Core Net Profit (%)	25.0	(30.0)	(15.0)	32.7	13.9

Balance Sheet

FYE 31 Dec (RMmn)	2018	2019	2020E	2021F	2022F
PPE	2,216.8	2,396.5	2,499.1	2,637.9	2,734.6
Intangible Asset	97.3	97.5	97.5	97.5	97.5
Associate	1.7	1.6	1.6	1.7	1.7
Others	260.3	393.4	393.4	393.4	393.4
Non-current assets	2,576.1	2,888.9	2,991.6	3,130.5	3,227.3
Inventories	575.6	679.6	717.4	777.0	821.0
Trade receivables	649.2	496.1	675.0	733.5	775.1
Cash and Bank Balance	458.9	764.8	625.3	512.1	543.4
Others	574.2	579.6	579.6	579.6	579.6
Current assets	2,257.9	2,520.2	2,597.3	2,602.2	2,719.1
Total Assets	4,834.0	5,409.1	5,588.9	5,732.7	5,946.4
LT Borrowings	1,016.0	873.1	891.4	873.1	873.1
Others	167.8	252.6	252.6	252.6	252.6
Non-Current liabilities	1,183.8	1,125.7	1,144.1	1,125.7	1,125.7
Trade payables	248.9	273.5	277.0	300.5	319.0
ST Borrowings	1,304.8	1,508.7	1,540.4	1,508.7	1,508.7
Others	331.1	320.6	320.6	320.6	320.6
Current liabilities	1,884.8	2,102.9	2,138.0	2,129.8	2,148.3
Shareholders funds	1,301.8	1,641.2	1,730.8	1,849.7	1,985.2
MI	463.6	539.3	576.0	627.4	687.1
Total Equity	1,765.4	2,180.5	2,306.8	2,477.2	2,672.3
Total E&L	4,834.0	5,409.1	5,588.9	5,732.7	5,946.4

Cash Flow Statement

FYE 31 Dec (RMmn)	2018	2019	2020E	2021F	2022F
Pretax profit	348.6	288.8	234.5	311.3	354.6
Depreciation	197.1	225.5	247.4	261.1	270.7
Net interest	101.0	123.8	110.5	112.3	111.6
Associates	(0.6)	(0.4)	(0.4)	(0.5)	(0.5)
Changes in WC	(241.8)	38.7	(213.2)	(94.6)	(67.1)
Tax	(75.7)	(57.0)	(61.5)	(81.7)	(93.0)
Others	20.7	37.6	0.0	0.0	0.0
Operational cash flow	349.2	656.9	317.2	507.9	576.1
Capex	(363.7)	(387.2)	(350.0)	(400.0)	(367.4)
Interest income	1.4	12.9	9.9	8.1	7.5
Others	(16.3)	1.3	0.4	0.4	0.5
Investing cash flow	(378.6)	(373.0)	(339.7)	(391.5)	(359.4)
Net share issue	0.0	269.6	0.0	0.0	0.0
Net borrowings	204.2	(7.2)	50.0	(50.0)	0.0
Dividend paid	(66.3)	(84.5)	(46.7)	(59.2)	(66.3)
Interest paid	(108.6)	(136.6)	(120.3)	(120.3)	(119.1)
Others	(36.2)	(43.9)	0.0	0.0	0.0
Financial cash flow	(6.9)	(2.7)	(117.0)	(229.6)	(185.4)
Net cash flow	(36.2)	281.1	(139.6)	(113.2)	31.3
Beginning Cash	427.4	390.4	670.8	531.2	418.1
Forex & others	(0.8)	(0.7)	0.0	0.0	0.0
Ending Cash	390.4	670.8	531.2	418.1	449.3

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Recommendation Guideline

- BUY** : Total return within the next 12 months exceeds required rate of return by 5%-point.
HOLD : Total return within the next 12 months exceeds required rate of return by between 0-5%-point.
SELL : Total return is lower than the required rate of return.
Not Rated: The company is not under coverage. The report is for information only.

Total Return is defined as expected share price appreciation plus gross dividend over the next 12 months. Gross dividend is excluded from total return if dividend discount model valuation is used to avoid double counting.

Required Rate of Return of 7% is defined as the yield for one-year Malaysian government treasury plus assumed equity risk premium.

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As of Tuesday, April 28, 2020, the analyst, Jeff Lye Zhen Xiong, who prepared this report, has interest in the following securities covered in this report:
(a) nil

Kaladher Govindan – Head of Research

TA SECURITIES HOLDINGS BERHAD (14948-M)

A Participating Organisation of Bursa Malaysia Securities Berhad

Menara TA One | 22 Jalan P. Ramlee | 50250 Kuala Lumpur | Malaysia | Tel: 603 – 2072 1277 | Fax: 603 – 2032 5048
www.ta.com.my