

## Earnings Accretive Integration

### Company Update

- Leong Hup International Bhd (LHI) has acquired the entire equity interest in food manufacturer and distributor The Baker's Cottage Sdn Bhd (TBC) for RM17.9 mln. Its wholly-owned subsidiary Leong Hup (M) Sdn Bhd bought the 43.4 mln shares from Emerging Glory Sdn Bhd, which is owned by LHI executive chairman Lau Chia Nguang, his brothers and their nephews who also sat on LHI's board.
- Leong Hup (M), through unit Leong Hup Agrobusiness Sdn Bhd, also inked agreements to acquire TBC brand bakery business from Astaka Shopping Centre (Muar) Sdn Bhd for RM1.5 mln and TBC retail business owned and operated by Poly-Yarn Industries Sdn Bhd for RM862,126. Astaka owns and operates six outlets in Johor, Melaka, and Negeri Sembilan while Poly-Yarn Industries owns and operates three outlets in Selangor.
- The proposals will allow LHI to own the Bakers Cottage brand and integrate vertically downward to capture incremental value added from its poultry-related product sales and provide margin stability in times of live broilers supply-demand imbalance.
- We gather that TBC Group has delivered RM593,000 in net profit on top of a RM41.6 mln in revenue. We deem the acquisition to be fair at 1.2x of the net book value of the group. The purchase consideration for the Proposals will be financed through internally generated funds and/or bank borrowings. The acquisition is expected to be completed in 3Q2020.

Financial Highlights					
FYE Dec (RM mln)	2017	2018	2019	2020F	2021F
Revenue	5501.4	5732.4	6054.8	6037.0	6223.5
EBITDA	576.6	646.1	637.6	613.8	656.7
Net Profit	192.6	184.7	150.6	142.8	161.9
Revenue Growth (%)	4.6	4.2	5.6	-0.3	3.1
EBITDA Growth (%)	-14.0	12.1	-1.3	-3.7	7.0
Net Profit Growth (%)	-8.1	-4.1	-18.5	-5.2	13.4
EPS (sen)	5.3	5.1	4.1	3.9	4.4
P/E (x)	12.9	13.4	16.5	17.4	15.3
Dividend Yield (%)	1.5	1.5	2.4	1.8	1.8
P/BV (x)	2.1	1.9	1.5	1.5	1.5
ROE (%)	6.7	6.2	4.1	3.8	4.2

Source: Company Data & MSSB Research

**Recommendation: HOLD**

**Share Price: RM0.71**

**Target Price: RM0.68**

**Expected Return: +4.3%**

**Expected Dividend Return: +1.8%**

**Expected Total Return: +6.2%**

**FBM KLCI: 1,490.14**

### Key Statistics

**Bursa Code:** 6633

**Bloomberg Ticker:** LHIB MK Equity

**Stock Information:** Principally involved in distribution of animal feed raw materials, food related products and livestock farming

**Listing Market:** Main Market

**Share Issued (bln):** 3.65

**Market Capital (RM bln):** 2.48

**Par Value (RM):** N/A

**52 week high/low:** RM1.07/RM0.43

**Estimated free float:** 85.1%

**Beta (x):** 1.2

**3-month average volume ('000):** 2,554.0

**Major Shareholders:**

Clarinden Investments Pte Ltd	9.0%
Lau Joo Han	2.1%
Lau Eng Guang	1.6%

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## Valuation and Recommendation

We view the acquisition to be earnings accretive to LHI over the long run as the move will improve bottomline margins for the group under the livestock business segment by eliminating part of the supply chain cost to reach out their products to retailers. At the same time, the recent promotion launched by the group which entails a whole roasted chicken (BBQ/black pepper flavour) at RM10.90 has garnered tremendous positive response across the TBC branches over the past months.

We raised our net profit 4.0% and 6.7% to RM142.8 mln and RM161.9 mln for 2020 and 2021 respectively to account for the improved margins and firmer demand from TBC. Consequently, we maintain our **HOLD** recommendation on LHI, but with a higher fair value of RM0.71 (from RM0.60) as we rolled over our valuation metrics to 2021.

Our target price is based on an unchanged target PER of 16.0x to our revised 2021 estimated EPS of 4.4 sen. The assigned target PER represents a 20.0% discount to its local and regional peers' average of 20.0x, after taking into account of the larger market capitalisation of its peers like Charoen Pokphand Foods PLC and ThaiFoods Group PLC in Thailand, JAPFA Ltd in Singapore, and **QL Resources Bhd** in Malaysia.

Risks to our recommendation and forecast include fluctuations in raw material prices (corn and soybean) that could impact LHI's margins. LHI purchases raw materials 1-3 months ahead and stocks are kept for approximately two months. Any drastic fluctuation in ASP of LHI's output (DOCs and broilers) will affect bottomline margins.

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Income Statement					
FYE Dec (RM mln)	2017	2018	2019	2020F	2021F
Revenue	5,501.4	5,732.4	6,054.8	6,037.0	6,223.5
EBITDA	576.6	646.1	637.6	613.8	656.7
Depreciation & Amortisation	199.1	197.1	225.5	257.3	262.9
Net Interest Expense	-85.7	-102.5	-123.8	-111.4	-115.8
Pre-tax Profit	292.3	347.1	288.8	245.6	278.5
Effective Tax Rate	15.3%	29.3%	26.2%	25.0%	25.0%
Net Profit	192.6	184.7	150.6	142.8	161.9
EBITDA Margin	10.5%	11.3%	10.5%	10.2%	10.6%
PreTax Margin	5.3%	6.1%	4.8%	4.1%	4.5%
Net Margin	3.5%	3.2%	2.5%	2.4%	2.6%

Source: Company Data & MSSB Research

Balance Sheet					
FYE Dec (RM mln)	2017	2018	2019	2020F	2021F
Total Assets	4477.5	4834.0	5409.1	5456.6	5558.7
Fixed Assets	2210.1	2396.8	2418.5	2458.5	2320.1
Current Assets	2066.6	2257.9	2520.2	2509.0	2729.9
Other LT Assets	200.8	179.3	470.4	489.1	508.6
Current Liabilities	1940.3	1884.8	2102.9	2136.4	2193.7
LT Liabilities	895.1	1183.8	1125.7	1034.2	1050.1
Share Capital	1230.1	1230.1	1499.7	1499.7	1499.7
Shareholder's Funds	1185.6	1301.8	1641.2	1688.3	1704.6
Minority Interests	456.4	463.6	539.3	597.7	610.3

Source: Company Data & MSSB Research

Per Share Data					
FYE Dec	2017	2018	2019	2020F	2021F
Book Value (sen)	32.5	35.7	45.0	46.3	46.7
Cash Flow (sen)	12.8	7.7	15.7	13.2	13.5
Net Earnings (sen)	5.3	5.1	4.1	3.9	4.4
Dividend (sen)	1.1	1.0	1.6	1.3	1.3
Payout Ratio (%)	19.9	19.8	38.8	32.0	28.2
Dividend Yield (%)	1.5	1.5	2.4	1.8	1.8
PER (x)	12.9	13.4	16.5	17.4	15.3
P/Cash Flow (x)	0.1	0.1	0.0	0.1	0.1
P/Book Value (x)	2.1	1.9	1.5	1.5	1.5
ROE (%)	6.7	6.2	4.1	3.8	4.2
Net Gearing (%)	103.0	108.3	79.6	72.9	64.8

Source: Company Data & MSSB Research

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