

Leong Hup International Bhd

TP: RM0.910 (+13.1%)
Potentials in TBC Downstream Integration
Last Traded: RM0.805
Buy

Jeff Lye Zhen Xiong, CFA

Tel: +603-2167 9730

jefflye@ta.com.my

www.taonline.com.my

We had a meeting with management discussing about LHI's strategy of venturing into downstream through The Baker Cottage (TBC) and find the opportunity from such venture promising. While earnings contribution from TBC may be marginal in FY20, we believe it would pick up from FY21 onwards as its network becomes more established. Maintain Buy recommendation with a higher target price of RM0.910/share as we incorporate TBC's financial impact on LHI and revise our target PER to 18x CY21 EPS.

Recap on TBC Acquisition

LHI entered into three transactions to acquire TBC for an aggregated cash consideration of RM20.3mmn in early June-2020. These transactions involve 100% shares acquisition of TBC from Emerging Glory, acquisitions of 6 TBC retail outlets from Astaka Shopping Centre (Muar) and acquisitions of 3 TBC retail outlets from Poly-Yarn Industries.

Though the transactions are considered a related party transaction, we like to stress that TBC brand was first founded by Leong Hup (Malaysia) in 1994 before disposed off to Emerging Glory in 2017 as the then bakery manufacturing and trading business was not in line with LHI's core business of integrated poultry industry. However in 2018, TBC (under Emerging Glory) began repositioning itself as a quick-service restaurant through introduction of roast whole chicken and chicken rice set. As such, we view the transactions as strategic vertical acquisitions rather than assistance to Emerging Glory to cash out.

According to announcement, the original investment into TBC by the respective acquirees during 2016-2018 was RM23.5mmn (inclusive of Emerging Glory's 2017 acquisition cost of RM20.3mmn) and TBC's FY19 revenue and net profit were RM41.6mmn and RM0.6mmn respectively. While the 1-year trailing acquisition multiple of 34x PER may appear high on first sight, it is worth noting that TBC has high net asset value and is in a better condition now compared to 2017 when Leong Hup (Malaysia) sold TBC for RM20.3mmn. LHI's management shared that the currently profitable TBC was making losses of RM7.7mmn in 2017.

Embarking the Downstream Venture

Through the acquisitions, LHI regained ownership on the TBC brand and expanded into quick-service restaurant business serving cakes, buns, pastries alongside roast chickens and poultry-related products. To date, LHI runs over 50 TBC outlets and is on sight to own 80 outlets by end-2020 and 300 outlets across Peninsula Malaysia by 2023. We do not think this is over-ambitious as the expansion plans are supported by i) strong demands for value and affordable ready-to-eat products, ii) vast opportunity in sub-urban townships, iii) TBC's halal certified products that appeal to Malaysian demographic, and most importantly iv) synergies against LHI's existing upstream business to drive

Share Information

Bloomberg Code	LHI MK
Stock Code	6633
Listing	Main Market
Share Cap (mn)	3650.0
Market Cap (RMmn)	2938.3
52-wk Hi/Lo (RM)	1.04/0.43
12-mth Avg Daily Vol ('000 shrs)	3547.4
Estimated Free Float (%)	21.4
Beta	nm
Major Shareholders (%)	

 Emerging Glory - 52.8%
 Clarinden Investment - 9.0%

Forecast Revision (%)

	FY20	FY21
Forecast Revision (%)	2.2	8.7
Net Profit (RM mn)	130.9	184.7
Consensus	131.4	176.4
TA/Consensus (%)	99.6	104.7
Previous Rating	Buy (Maintained)	

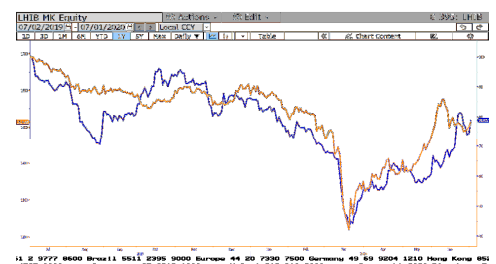
Financial Indicators

	FY20	FY21
Net debt/equity (%)	0.8	0.8
ROE (%)	7.8	10.3
ROA (%)	2.4	3.3
NTA/Share (RM)	0.4	0.5
Price/NTA (x)	1.8	1.7

Share Performance

Price Change (%)	LHI	FBM KLCI
1 mth	22.0	0.4
3 mth	41.2	13.8
6 mth	(8.0)	(5.5)
12 mth	(21.1)	(10.2)

(12-Mth) Share Price relative to the FBMKLCI



Source: Bloomberg

volume growth and provide margin stability for the group.

Expect Meaningful Contributions upon Established Sales Network

The immediate priority for TBC is to scale up the number of outlets and to increase brand awareness, of which we believe LHI's strategy to adopt penetrative product pricing has been effective. During the Movement Control Order period, TBC has introduced promotional prices on its products with a whole roast chicken priced at an unbelievably low price of RM9.90. The promotion went viral garnering overwhelming response with daily sales of roast chickens increasing from average 4,500 birds to a peak of 14,500 birds. After the lapse of aforementioned promotion, prices were raised by c.10% yet TBC's roast chickens, cakes and pastries continue to experience strong demands.

Considering that LHI will focus on brand building and network expansion in the near term, we believe earnings contribution from TBC in FY20 would be marginal. However, TBC's contributions are expected to pick up from FY21 onwards as its network becomes more established. Moreover, synergies of driving the group's chicken sales volume through TBC could yield remarkable results. Capital expenditure per TBC outlet is estimated at c.RM500k with a payback period of c.4 years.

TBC could become the Largest with Products Offering the Best Value

The Chicken Rice Shop (TCRS) and Ayamas are the commonly known large restaurant chains in Malaysia with roast chicken being their key specialty. According to their corporate website, TCRS and Ayamas have 109 and 58 outlets respectively, which indicate TBC's number of outlets is catching up and could become the largest restaurant chain among the three by 2021. While each company has its own unique business concept and sales strategy, TBC is found to be offering the best product value with significantly low price. TBC, TCRS and Ayamas' price of promotional chicken set meal (includes one chicken serving and a drink/side) is RM6.90/10.45/10.90 while price of promotional whole chicken is RM10.90/59.00/20.90 respectively. We believe the strengths in LHI's existing poultry farming and processing activities has enabled TBC the flexibility to price competitively.

Impact

We make some assumptions on TBC and incorporate the financial impacts into our earnings forecast, thus increase our LHI's FY20/21/22 earnings estimate by 2.2/8.7/11.4%.

Our new assumptions include:

- i) c.6 new stores opening per month with a target of 300 units by end 2023;
- ii) Average daily sales/store of c.RM4,600-RM4,800;
- iii) EBITDA margin of c.13-15%; and
- iv) FY20-22 capex of RM40-55mn for TBC.

Valuation

We believe the worst of poultry prices has come to an end amid reopening of restaurants post MCO. Also, we see improved clarity on LHI's downstream integration alongside the promising outlook for its quick-service restaurant business concept with focus on affordable products. As such, we upgrade our target PE to 18x CY21 EPS (previously 14x) and arrive at a new target price of RM0.910/share (previously RM0.650). **Maintain Buy.**

Earnings Summary

Profit and Loss Statement

FYE 31 Dec (RMmn)	2018	2019	2020E	2021F	2022F
Revenue	5,746.6	6,054.8	6,195.4	6,828.6	7,288.7
EBITDA	646.1	636.9	607.9	726.9	797.4
Depreciation	(197.1)	(225.5)	(257.9)	(276.3)	(290.6)
Net finance cost	(101.0)	(123.8)	(110.7)	(112.8)	(112.3)
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	239.8	338.3	395.0
Taxation	(101.8)	(75.8)	(62.9)	(88.8)	(103.7)
MI	(60.6)	(62.4)	(46.0)	(64.9)	(75.8)
Net profit	186.2	150.6	130.9	184.7	215.6
Core net profit	215.2	150.6	130.9	184.7	215.6

Core EPS (sen)	5.9	4.1	3.6	5.1	5.9
Diluted EPS (sen)	5.9	4.1	3.6	5.1	5.9
DPS (sen)	0.0	1.6	1.1	1.5	1.8
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)	13.7	19.5	22.5	15.9	13.6
Div. Yield (%)	0.0	2.0	1.3	1.9	2.2
P/BV (x)	1.7	1.3	1.3	1.2	1.1

Profitability ratios

EBITDA margin (%)	11.6	10.5	9.8	10.6	10.9
PBT margin (%)	6.5	4.8	3.9	5.0	5.4
Core Net Margin (%)	3.7	2.5	2.1	2.7	3.0
Core ROE (%)	17.3	10.2	7.8	10.3	11.1
Core ROA (%)	4.6	2.9	2.4	3.3	3.7

Liquidity ratios

Current ratio (x)	1.2	1.2	1.2	1.2	1.3
Quick ratio (x)	0.9	0.9	0.9	0.8	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	2.3	10.2	6.7
PBT (%)	19.3	(17.2)	(17.0)	41.1	16.8
Core Net Profit (%)	25.0	(30.0)	(13.1)	41.1	16.8

Balance Sheet

FYE 31 Dec (RMmn)	2018	2019	2020E	2021F	2022F
PPE	2,216.8	2,396.5	2,528.6	2,682.3	2,794.1
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	3,021.1	3,174.9	3,286.7
Inventories	575.6	679.6	720.1	787.2	837.1
Trade receivables	649.2	496.1	678.9	748.3	798.8
Cash and Bank Balance	458.9	764.8	593.2	465.1	492.2
Others	574.2	579.6	579.6	579.6	579.6
Current assets	2,257.9	2,520.2	2,571.9	2,580.3	2,707.7
Total Assets	4,834.0	5,409.1	5,592.9	5,755.2	5,994.4
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	278.0	304.4	325.2
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	2,139.1	2,133.8	2,154.6
Shareholders funds	1,301.8	1,641.2	1,732.8	1,862.1	2,013.0
MI	463.6	539.3	577.0	633.6	701.1
Total Equity	1,765.4	2,180.5	2,309.8	2,495.7	2,714.1
Total E&L	4,834.0	5,409.1	5,592.9	5,755.2	5,994.4

Cash Flow Statement

FYE 31 Dec (RMmn)	2018	2019	2020E	2021F	2022F
Pretax profit	348.6	288.8	239.8	338.3	395.0
Depreciation	197.1	225.5	257.9	276.3	290.6
Net interest	101.0	123.8	110.7	112.8	112.3
Associates	(0.6)	(0.4)	(0.4)	(0.5)	(0.5)
Changes in WC	(241.8)	38.7	(218.8)	(110.1)	(79.5)
Tax	(75.7)	(57.0)	(62.9)	(88.8)	(103.7)
Others	20.7	37.6	0.0	0.0	0.0
Operational cash flow	349.2	656.9	326.2	528.0	614.2
Capex	(363.7)	(387.2)	(390.0)	(430.0)	(402.4)
Interest income	1.4	12.9	9.6	7.5	6.8
Others	(16.3)	1.3	0.4	0.4	0.5
Investing cash flow	(378.6)	(373.0)	(380.0)	(422.0)	(395.1)
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)	(47.5)	(63.7)	(73.0)
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)	(117.9)	(234.0)	(192.1)
Net cash flow	(36.2)	281.1	(171.7)	(128.0)	27.1
Beginning Cash	427.4	390.4	670.8	499.1	371.1
Forex & others	(0.8)	(0.7)	0.0	0.0	0.0
Ending Cash	390.4	670.8	499.1	371.1	398.2

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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 Thursday, July 02, 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