



AmInvestment Bank

Company report

LEONG HUP INTERNATIONAL

(LHIB MK EQUITY, LEOG.KL)

17 June 2019

Rules the roost in poultry industry

BUY

(Initiation)

Thong Pak Leng

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03-2036 2025

Rationale for report: Initiation

Price	RM1.07
Fair Value	RM1.43
52-week High/Low	RM1.19/RM1.01

Key Changes

Fair value	Initiation
EPS	Initiation

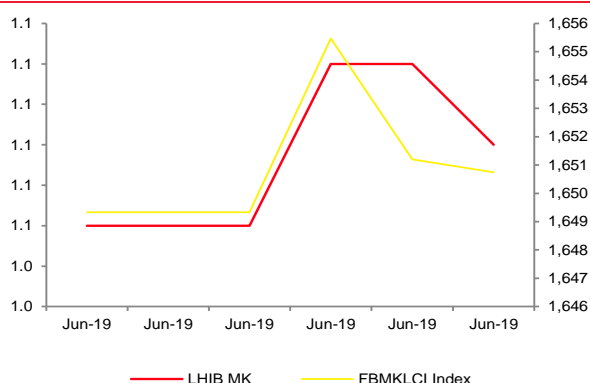
YE to Dec	FY18	FY19F	FY20F	FY21F
Revenue (RM mil)	5,746.6	6,198.0	6,703.9	7,214.7
Core net profit (RM mil)	186.1	240.7	260.5	281.2
FD Core EPS (sen)	5.1	6.6	7.1	7.7
FD Core EPS growth (%)	(3.4)	29.4	8.2	7.9
Consensus Net Profit (RM mil)	-	-	-	-
DPS (sen)	0.0	2.0	2.1	2.3
PE (x)	20.4	15.8	14.6	13.5
EV/EBITDA (x)	8.8	7.7	7.5	7.3
Div yield (%)	0.0	1.9	2.1	2.2
ROE (%)	15.0	15.8	14.2	13.9
Net Gearing (%)	146.9%	106.3%	111.3%	114.9%

Stock and Financial Data

Shares Outstanding (million)	3,650.0
Market Cap (RM mil)	3,976.0
Book Value (RM/share)	0.4
P/BV (x)	2.7
ROE (%)	14.3%
Net Gearing (%)	146.9%

Major Shareholders	Clarinden Inv Pte.	8.0%
	Lau Joo Han	1.9%
	Dato' Lau Eng Guang	1.5%
Free Float	88.7%	
Avg Daily Value (RM mil)	-	

Price performance	3mth	6mth	12mth
Absolute (%)	-	-	-
Relative (%)	-	-	-



Investment Highlights

- We initiate coverage on Leong Hup International (LHI) with a BUY recommendation, pegging a fair value of RM1.43. Our valuation is based on 20x PER over FY20 earnings which is at a discount to its regional peers' market cap weighted average of 23.4x FY20 earnings (Exhibit 18). We believe LHI's 20x valuation is justified given its significant regional presence, production scale and a clear expansion plan (Exhibit 13).
- LHI is one of the largest fully integrated producers of poultry, eggs and livestock feed in Southeast Asia. At present, LHI operates in Malaysia, Singapore, Indonesia, Vietnam and the Philippines, which are attractive consumer markets, with a population of almost 500mil people with significant growth potential.
- The fully integrated business model provides flexibility, synergies and resilience through economic cycles. With detailed expansion plans for its feed mills and livestock businesses in Malaysia, Vietnam and the Philippines, we believe the long-term prospects for LHI to be positive.
- With an annual production of 495mil day-old chicks (DOCs), 99mil broiler chickens, close to 2mil MT of livestock feed and more than 1.7bil eggs, LHI has the scale which provides advantage over smaller players across the value chain such as bargaining power, outsourcing of raw materials and the production and distribution of poultry and livestock feed.
- We are projecting LHI's PATAMI to grow by 29.4%, 8.2% and 7.9% to RM240.7mil, 260.5mil and 281.2mil for FY19–FY21F respectively, representing a 3-year CAGR of 14.7%.
- Management is targeting a payout ratio of approx. 30% from the group's PATMI each year. We expect LHI to pay dividends of 2.0 sen, 2.1 sen and 2.3 sen for FY19–FY21 translating into yields of 1.9%, 2.1% and 2.2% respectively.
- The stock offers a potential upside of more than 30% and dividend yield of 1.9%. We initiate coverage on LHI with a BUY recommendation.
- Our BUY recommendation is premised on the group's stable earnings from Malaysia and Singapore's business while regional expansion at Vietnam and the Philippines provides growth potential.

CORPORATE PROFILE

□ *Brief history*

The story of LHI started in the 1960s when the founding family commenced broiler chicken rearing on a backyard farming basis in Muar, Johor. Adoption of modern techniques and effective cost control measures enabled the business to prosper, with more family members joining the management team. The business expanded vertically into breeder farms, slaughterhouses and food processing.

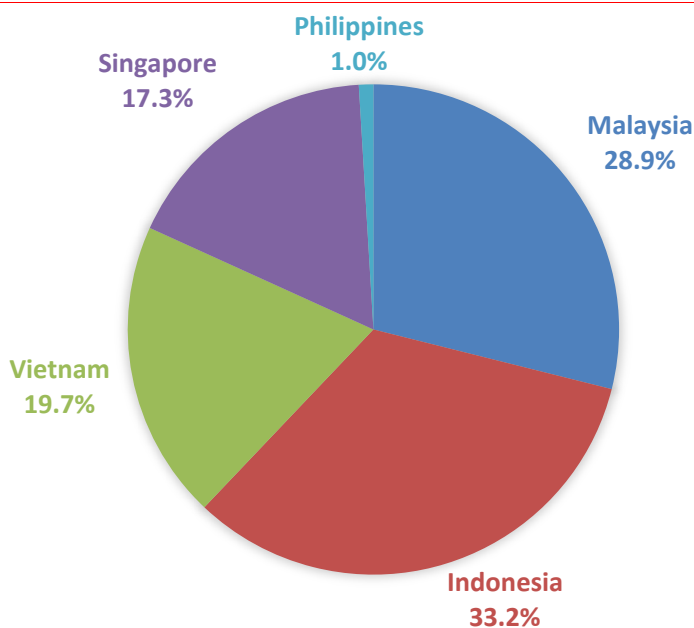
Over the next 20 years, the group's business grew in scale and further diversified its operations vertically into livestock feed production and trading (under Emivest Bhd) and layer farming (under Teo Seng Capital Bhd) in Malaysia; food processing and trading under Lee Say Group in Singapore; integrated poultry farming and feedmill production under PT Malindo Feedmill TBK in Indonesia; and integrated poultry and feed mill under Emivest Vietnam Group in Vietnam.

□ *Key regional player*

Today, LHI is one of the largest fully integrated producers of poultry, eggs and livestock feed in Southeast Asia. At present, LHI operates in Malaysia, Singapore, Indonesia, Vietnam and the Philippines, which are attractive consumer markets, with a population of almost 500mil people and significant growth potential. LHI's operations consist of:

- i) **Feedmill business.** Comprises the formulation, production and sale of feed for a variety of livestock; and
- ii) **Livestock business.** Comprises the rearing of grandparent stock (GPS) DOCs, parent stock (PS) DOCs and broiler DOCs for both internal use and external sale; the sale of broiler chickens; distribution of fresh eggs from layer chickens; the sale of ducks; and the distribution of fresh and processed consumer food products.

EXHIBIT 1: GEOGRAPHICAL BREAKDOWN OF REVENUE (FY18)



Source: AmlInvestment Bank Bhd, Company

BUSINESS OPERATIONS

Feedmill business

LHI is the largest integrated producer of livestock feed in Malaysia and the third largest in Indonesia and Vietnam by annual production output. At present, the group has a market share of approx. 10% in Malaysia, 5% in Indonesia and 4% in Vietnam.

The group produces feed for GPS, PS, broiler chicken, layer chicken, broiler duck, swine, quail, aquatic animals and certain domestic pets. Key brand names include “Leong Hup” in Malaysia and Vietnam; and “Malindo” in Indonesia.

LHI operates five (5) feed mills in Malaysia, five (5) in Indonesia and three (3) in Vietnam with a combined production capacity of 2.6mil MT as at 31 Oct 2018.

Raw materials

The primary raw materials used in production of livestock feed are mainly corn and soybean which are imported from South America, except for Indonesia where the materials are domestically produced.

LHI uses automated computerized batching software such as the Bühler Group’s WINCOS and Muyang Co’s MYCOS to weigh raw materials prior to mixing. Once the raw materials have been mixed, the mashed feed undergoes a conditioning and pelleting process, which seeks to eliminate pathogens and improve the digestibility of the livestock. Once cooled, the feed is sent to packing bins or bulk bins bagged in 25kg or 50kg bags and stored in warehouses, pending delivery to customers.

Quality control

Five of LHI’s feed mills received the ISO QMS while six obtained the ISO FSMS certification. The group’s nutrition plant has received HACCP accreditation. LHI’s suppliers are evaluated based on a number of criteria such as reputation, price and quality. The raw materials are tested in both physical and chemical aspects to ensure they meet the standards required. All raw materials are stored in a tightly controlled and closely monitored storage unit in accordance with stringent quality control programmes and quality assurance systems.

EXHIBIT 2: ANNUAL FEED MILL CAPACITY, PRODUCTION AND UTILIZATION RATE

	Feedmill capacity (MT)				Annual production (MT)				Utilization rate			
	FY2015	FY2016	FY2017	FPE 31/10/18	FY2015	FY2016	FY2017	FPE 31/10/18	FY2015	FY2016	FY2017	FPE 31/10/18
Malaysia	701,544	701,544	701,544	735,102	546,276	600,564	642,233	551,929	77.9%	85.6%	91.5%	75.1%
Indonesia	1,129,920	1,172,160	1,172,160	976,800	653,376	649,961	712,194	641,157	57.8%	55.4%	60.8%	65.6%
Vietnam	498,960	653,400	831,600	891,000	464,413	563,436	627,255	564,533	93.1%	86.2%	75.4%	63.4%
Total	2,330,424	2,527,104	2,705,304	2,602,902	1,664,065	1,813,961	1,981,682	1,757,619	71.4%	71.8%	73.3%	67.5%

Source: AmlInvestment Bank Bhd, Company

EXHIBIT 3: RAW MATERIALS PURCHASED

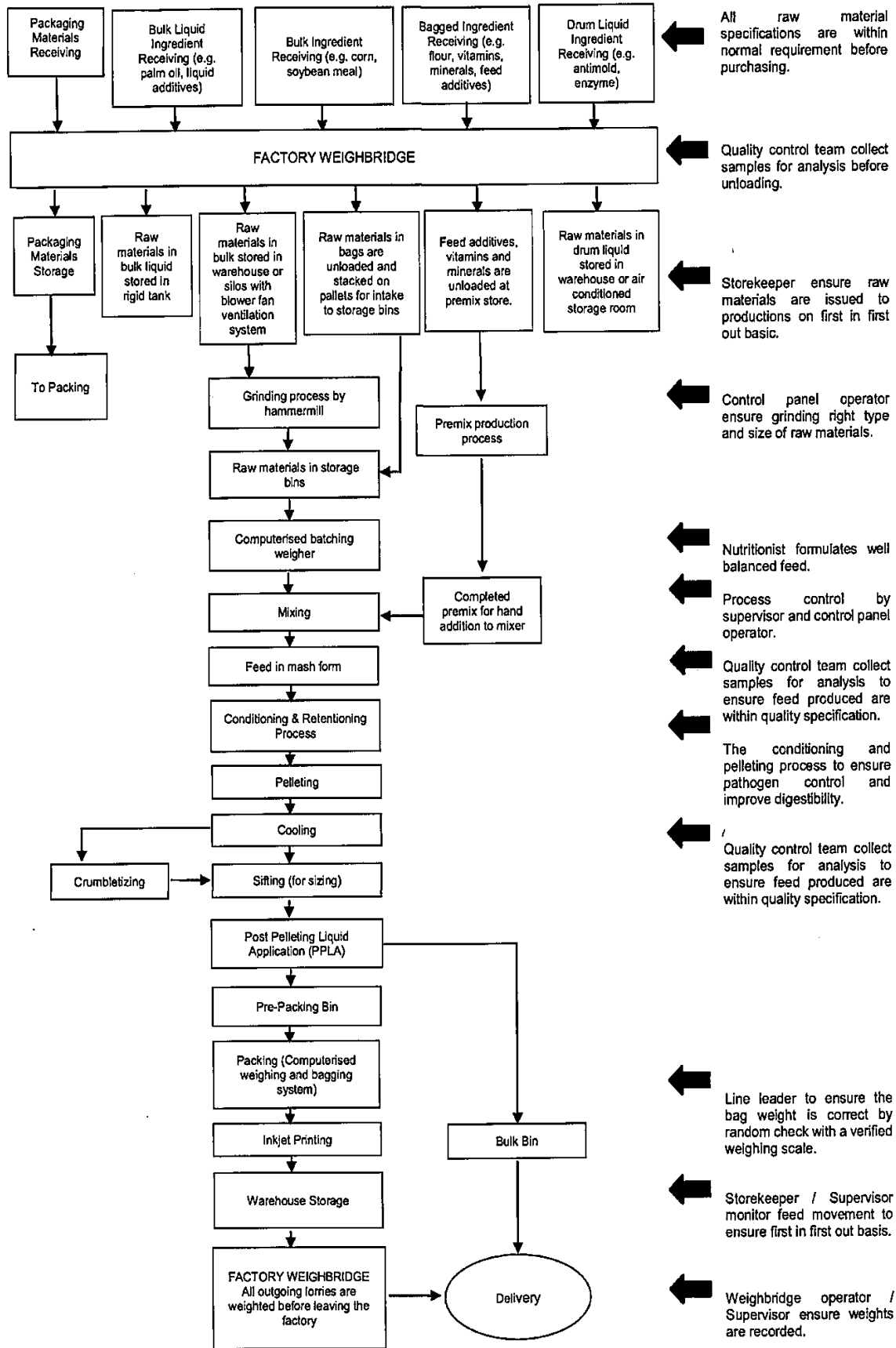
	Quantity purchased (MT)			
	FY2015	FY2016	FY2017	FPE 31/10/18
Corn	823,265	743,718	765,029	756,657
Soybean	368,453	404,534	418,821	396,576
Others	-	178,532	225,962	279,893

Source: AmlInvestment Bank Bhd, Company

Manufacturing process

Manufacturing process is shown in Exhibit 4. The quality control team will perform inspection of incoming raw materials and ingredients. Raw materials and ingredients which failed the inspection will be returned to suppliers. Meanwhile, raw materials and ingredients which passed the inspection will be transferred to the warehousing department for weighing and storage.

EXHIBIT 4: MANUFACTURING PROCESS



Source: AmlInvestment Bank Bhd, Company

□ Livestock business

LHI's livestock business are divided into two main business operations:

- i) Chicken production – production of PS DOCs, broiler DOCs and broiler chicken, the slaughtering of broiler chicken and further food processing; and
- ii) Egg production – the production of layer DOCs and table eggs.

The group operates 237 farms and hatcheries spread across Malaysia, Indonesia, Vietnam and the Philippines; and six (6) slaughtering plants in Malaysia, Indonesia and Singapore. In addition, the group has 618 contract farms to increase its capacity.

Chicken production

Chicken production is part of LHI's core business which includes the production of PS DOCs, broiler DOCs and broiler chicken, slaughtering of broiler chicken and further food processing.

Egg production

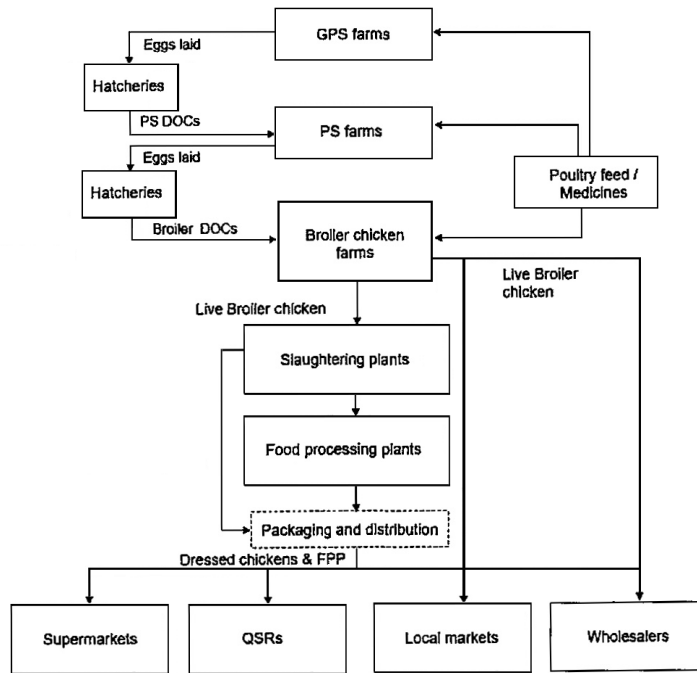
Layer chickens are nurtured in layer farms to produce eggs for commercial purposes. LHI produces a range of fresh eggs, including normal Grade A to F eggs as well as premium branded eggs enriched with Omega-3 fatty acid and Lutein.

EXHIBIT 5: CHICKEN PRODUCTION

i) Purchase of GPS	LHI purchases approx. 11,000 GPS DOCs per month exclusively from Europe, two (2) different breeds namely "Ross" and "Cobb".
ii) Rearing and breeding of GPS	GPS DOCs are transported to the GPS farms and will grow approx. 24 weeks and lay eggs for approx. 42 weeks. The eggs take 3 weeks to hatch. On average, each Ross GPS produces 61 DOCs while each Cobb GPS produces 50 DOCs. Once the GPS have finished laying eggs, they will be transferred to slaughterhouses or sold to third-party slaughterhouse operators.
iii) Selection of PS DOCs	Each DOC will be assessed to ensure it meets the requisite standards for breeding purposes and will then be classified as PS DOC. The DOCs which do not meet the standards will be classified as broiler DOCs. For 31 Oct 2018, approx. 48%-52% of DOCs were classified as PS DOCs.
iv) PS DOCs	The PS DOCs are transported to PS DOC farms where they will grow for approx. 24 weeks, lay eggs for approx. 42 weeks. The eggs then take three weeks to hatch. On average, each Ross PS produces 152 DOCs while each Cobb PS produces 147 DOCs. Once the GPS have finished laying eggs, they will be transferred to slaughterhouses or sold to third-party slaughterhouse operators.
v) Broiler DOCs	LHI sells approx. 70% of the broiler DOCs and retains and rears the remaining 30%. The broiler DOCs which LHI retain will be transported to the broiler chicken farms and contract farms where they are reared. The broiler DOCs typically achieve maturity in 5-7 weeks, and will then be transported to wholesalers, wet market traders and slaughterhouses.
vi) Slaughter	Broiler chickens are either slaughtered by trained Muslim slaughterers (if they have been designated as halal) or by a machine (non-halal).
vii) FPP	The chickens will then be apportioned into (ready-to-cook) RTC and (ready-to-eat) RTE for further processing. LHI produces a number of processed products namely "ayam A1", "SunnyGold" and "Ciki Wiki".

Source: AmlInvestment Bank Bhd, Company

EXHIBIT 6: CHICKEN PRODUCTION OPERATIONAL STRUCTURE



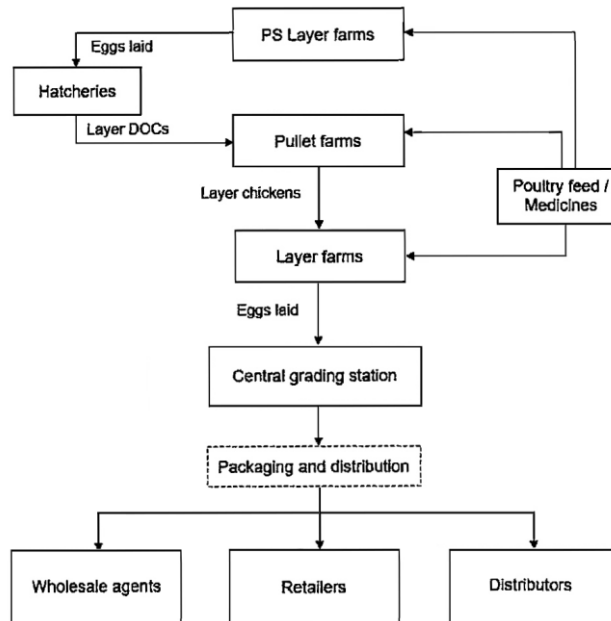
Source: AmlInvestment Bank Bhd, Company

EXHIBIT 7: EGG PRODUCTION

<p>i) PS Layers</p>	<p>LHI purchases 100% of its PS layer DOCs, of the “Hisex” breed from the Netherlands. The PS layer DOCs will grow over approx. 20 weeks to become PS layers. The PS layers will then lay eggs for approx. 50 weeks. The eggs take 3 weeks to hatch.</p> <p>Once the PS layers have finished laying eggs, they will be sold to downstream slaughterhouse operators.</p>
<p>ii) Layer DOCs</p>	<p>After hatching, about 85% of the layer DOCs are sold to third parties. The layer DOCs which LHI retains will grow approx. 16 weeks to become layer chickens. They will be sent to layer chicken farm where they lay eggs for approx. 68–73 weeks. Each layer chicken produces an average of six eggs per week.</p> <p>Once the layer chickens have finished laying eggs, they will be sold to downstream slaughterhouse operators.</p>
<p>iii) Sorting</p>	<p>Eggs are collected on a daily basis from both LHI’s and contract farms and will be transported to the central grading station where they are sorted, graded and packaged based on size and colour. The packaged eggs will be sold to third parties including wholesale agents, retailers and distributors.</p>
<p>iv) Packaging</p>	<p>The egg trays are produced in all jurisdictions other than Indonesia where the egg trays are purchased from a third party.</p>

Source: AmlInvestment Bank Bhd, Company

EXHIBIT 8: EGG PRODUCTION OPERATIONAL STRUCTURE



Source: AmlInvestment Bank Bhd, Company

OPERATIONS BY COUNTRY

Malaysia

LHI is the largest integrated poultry producer in Malaysia by annual sales of DOCs. The group operates six (6) PGS DOC farms, 19 PS DOC farms and 44 broiler chicken farms throughout the country. LHI also utilises 20 contract farms in Malaysia for housing broiler chicken. For broiler chicken, LHI has a housing capacity of: i) 120,000 GPS DOCs; ii) 1,902,950 PS DOCs; and iii) 10,473,000 broiler chickens (1,302,000 housed in contract farms).

LHI operates its egg production segment through Teo Seng Group (TSCB) which is a 26.83% associate company of LHI. TSCB is listed on Bursa Malaysia with a market capitalisation of around RM339mil as at 13 June 2019. TSCB has one (1) feed mill with a combined monthly production capacity of approx. 30,000 MT of livestock feed to support the production of 3.7mil eggs daily.

The group operates three layer farms in Malaysia, all located in Johor, with a housing capacity of 302,010 layer DOCs. For 2018, LHI supplied more than 16mil layer DOCs, of which approx. 3.1mil were sold to TSCB. LHI is the sole provider of layer DOCs to TSCB. TSCB produced and sold approx. 1.3bil eggs in 2018.

LHI imports PS day-old ducks (DODs) and produces DODs and broiler duck in 11 farms designated for duck production with a total housing capacity of 21,500 PS DODs and 291,500 broiler ducks. The duck production contributed about 2% of revenue in Malaysia livestock business for FPE 31 Oct 2018.

Apart from livestock feed and livestock business, the group also produced animal health products and organic fertilisers.

Indonesia

The group's operation in Indonesia is conducted via its 57.27 (as at 31 July 2018) subsidiary, Malindo Feedmill Tbk (Malindo Group), which is listed on the Jakarta Stock Exchange with a market cap of approx. IDR2.54tril (RM742mil) as at 13 June 2019. With over 20 years of experience, the Malindo Group is the third largest integrated poultry producer in Indonesia by annual supply of DOCs.

Malindo Group operates four (4) GPS DOC farms, 24 PS DOC farms and 25 broiler chicken farms in Indonesia. LHI also utilises 290 contract farms for housing broiler chicken. For broiler chicken, LHI has a housing capacity of: i) 96,000 GPS DOCs; ii) 2.8mil PS DOCs; and iii) 5.9mil broiler chickens (2.8mil housed in contract farms). Malindo Group has a domestic market share of 7% by annual supply of DOCs.

Malindo Group does not have any slaughterhouses in Indonesia and all broiler chickens are sold to third parties. However, the group has food processing operations where the products are sold under the brands "Sunny Gold", "Ciki Wiki" and "Sobat", distributed via hypermarkets such as Carrefour and Aerofood ACS.

For egg production, Malindo Group operates two (2) layer DOC farms and one (1) layer chicken farm in Indonesia with a total housing capacity of 172,210 layer DOCs and 268,000 layer chickens. In FY17, Malindo Group supplied 12.6mil layer DOCs, produced 55.6mil eggs and sold approx. 53.4mil eggs.

Malindo Group has one (1) farm designated for duck production while utilising 27 contract farms in Indonesia with a total housing capacity of 11,783 DODs and 395,424 broiler ducks. The duck production contributed approx. 3% of revenue to Indonesia livestock business for the FPE 31 Oct 2018.

LHI's main focus in Singapore is slaughtering and distribution of broiler chicken. Presently, the group has a domestic market share of 40% based on number of live chickens imported from Malaysia. On average, 1.8mil of broiler chickens are processed per month in three (3) slaughterhouses. For FY18 the sales of slaughtered broiler chicken contributed about 30% of the Singapore livestock business.

EXHIBIT 9: KEY OPERATIONAL DATA FOR LIVESTOCK BUSINESS

	2015	FYE 31 Dec 2016	2017	FPE 31 Oct 2018
Malaysia				
No of DOCs supplied (mil)	163.7	168.1	175.2	169.7
No of Broiler chickens supplied (mil)	57.1	55.8	56.9	50.1
Eggs sold (mil)	1,149.7	1,244.8	1,287.8	1,114.9
Indonesia				
No of DOCs supplied (mil)	227.2	232.7	240.9	188.4
No of Broiler chickens supplied (mil)	12.5	14.6	16.3	20.3
Eggs sold (mil)	39.2	60.9	53.4	42.4
Vietnam				
No of DOCs supplied (mil)	32.5	33.8	36.3	30.8
No of Broiler chickens supplied (mil)	21.2	19.4	20.8	20.5
Eggs sold (mil)	456.9	460.9	384.9	234.1
Singapore				
No of DOCs supplied (mil)	29.1	29.4	30.7	18.7
No of Broiler chickens supplied (mil)	12.5	12.2	11.6	7.7
Eggs sold (mil)	-	-	-	-
Philippines				
No of DOCs supplied (mil)	-	-	4.9	8.5
No of Broiler chickens supplied (mil)	-	0.4	1.4	2.8
Eggs sold (mil)	-	-	-	-

Source: AmlInvestment Bank Bhd, Company

Vietnam

LHI has been operating in Vietnam for 11 years and is the second largest integrated poultry producer in the country by annual supply of DOCs. The group does not rear GPS DOCs in Vietnam. Approx. 200,000 PS DOCs are supplied by the group's Malaysian livestock business division per year. In addition, the group purchased 100,000 PS DOCs per year each from Aviagen and Cobb.

LHI also purchases 8,000 "Sasso" PS DOCs per year from SASSO, France. The group operates four (4) PS DOC farms and 230 contract farms in Vietnam for housing broiler chicken. In total, LHI has a housing capacity of: i) 407,100 PS DOCs; and ii) 6.3mil broiler chickens.

For egg production, LHI operates one (1) layer DOC farms and three (3) layer chicken farms in Vietnam with a total housing capacity of 40,000 layer DOCs and 2.0mil layer chickens.

Singapore

The group's Singapore livestock farming operations are located in Malaysia which include four (4) PS DOC farms and 27 broiler chicken farms. LHI also utilises one contract farm in Malaysia for housing broiler chicken. LHI has a housing capacity of: i) 327,640 PS DOCs; and ii) 1.8mil broiler chickens for Singapore operations.

The group is also involved in the trading and storage frozen food including chicken, lamb, beef and seafood purchased from third parties from the USA, Brazil, Argentina and Australia and then sold to wholesalers. The current storage capacity is 8,650 pallets in 11 cold rooms.

Philippines

LHI's operation in the Philippines constitutes a small portion of the group's livestock business, accounting for 0.4% of total revenue in FY17. LHI operates two (2) PS DOC farms and one broiler chicken farms plus 10 contract farms for housing broiler chicken. In total, LHI has a housing capacity of: i) 122,940 PS DOCs; and ii) 660,000 broiler chickens (624,000 housed in contract farms).

INDUSTRY OUTLOOK FOR FOOD IS POSITIVE

❑ *Strong demand on the back of high population in Asean countries*

Asean has the third largest population in the world after China and India with a total of 650mil people as of 2018. The International Monetary Fund (IMF) projects it to reach 666.2mil in 2020. This growth, along with rising incomes which cause dietary changes such as eating more protein and meat, are fuelling the demand for food in the region.

❑ *Chicken is the most accepted type of meat globally*

Most religious dietary requirements do not limit chicken meat consumption. Consumption of swine is strictly forbidden for Muslims while beef is prohibited for Hindus, making chicken meat the preferred choice for multicultural consumer groups.

EXHIBIT 10: POPULATION AND AVERAGE AGE IN ASEAN AND SELECTED COUNTRIES/REGION

	USA	EU	Japan	China	ASEAN
Population - 2018 (mil)	328.1	510.9	126.7	1,397.0	650.5
2018E-2020F CAGR	0.6%	0.1%	-0.3%	0.4%	1.2%
Average age - 2018E	38.2	43.2	47.7	37.7	29.8

Source: AmlInvestment Bank Bhd, Company

EXHIBIT 11: URBANISATION RATE IN SELECTED ASEAN AND COUNTRIES/REGION

	Indonesia	Malaysia	Philippines	Singapore	Vietnam	ASEAN	US	EU	Japan	China
2012	51.3%	72.3%	45.7%	100.0%	31.8%	45.5%	81.1%	74.4%	91.1%	51.8%
2018E	55.3%	76.0%	46.9%	100.0%	35.9%	49.0%	82.3%	75.7%	91.6%	59.2%
2021F	57.3%	77.7%	47.7%	100.0%	38.1%	50.7%	82.9%	76.3%	91.9%	62.5%

Source: AmlInvestment Bank Bhd, Company

❑ *High urbanisation rate leading to change in consumer preference and lifestyle*

The demand for processed foods depends largely on the economic situation in a particular country or region. Where economic activity is growing, there is sufficient disposable income and growing urban populations who form the main markets for commercially processed foods. Urban lifestyles, growing distances between home and workplace are the leading factors for the increasing demand for shelf-stable and convenience foods.

❑ *Growing preference towards white meat*

The food industry is changing due to the changes in lifestyle, reshaped nutritional habits and needs of the consumers. Health has become the most cherished value which means more health friendly products and chicken meat benefits from the trend of higher consumption of white meat rather than red meat. This is due to the perceived health benefits since red meats are reported to be higher in saturated fat, which may lead to chronic diseases.

❑ *Affordability of poultry meat*

Greater economies of scale is one of the most influential factors in making chicken more affordable, mainly due to lower feed conversion ratio. According to scientific studies in the US, the conversion ratio for chicken is 1.85x as compared with swine's 2.75x and beef cattle's 4.5–7.5x. This may be correlated to shorter slaughter age of chicken compared with swine (5–6 months) and cattle (18 months).

❑ *Increase in food and beverage (F&B) outlets*

A wealth of new products and the increasing penetration of modern retailing have led to strong growth rates for F&B outlets across the Asean region. Consumers appear willing to experiment with new foods that complement their changing lifestyles. Collectively, the F&B industry in Malaysia, Indonesia, Singapore, Vietnam and the Philippines grew at a CAGR of 9.7% from 2012–2017 and is expected to grow at a CAGR of 8.4% from 2017–2020 (Frost & Sullivan analysis).

❑ *Growing quick-service restaurants (QSR) penetration*

Rising young population, high urbanisation rate, expanding disposable incomes, busy working adults and increased exposure to modern cuisine have led to the rise of QSR outlets.

EXHIBIT 12: POULTRY CONSUMPTION IN SELECTED ASEAN COUNTRIES 2012–2021F

Poultry meat consumption per capita (kg)	2012	2018E	2021F	2012-2018E CAGR	2018E-2021F CAGR	Total meat consumption per capita (2018E)
USA	44.6	49.8	49.1	1.8%	0.0%	101.3
OECD	27.2	30.6	31.0	2.0%	0.4%	70.3
EU	21.3	24.5	24.9	2.4%	0.6%	69.5
Japan	15.1	17.2	17.2	2.1%	0.1%	40.0
World	13.2	14.2	14.4	1.3%	0.4%	34.7
China	11.6	12.2	12.8	0.9%	1.8%	49.9
Indonesia, Malaysia, Philippines, Singapore & Vietnam	12.2	15.7	18.4	4.4%	5.4%	29.7
Developing Asia	8.2	8.9	9.3	1.4%	1.4%	27.2

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

Source: AmlInvestment Bank Bhd, Company

INVESTMENT MERITS

□ Fully integrated business model

LHI's business is spread over Malaysia, Indonesia, Vietnam, Singapore and the Philippines, including livestock feed manufacturing/marketing and the integrated poultry supply chain from breeding and rearing of PGS, PS and DOCs through to contract farming, slaughtering, food processing and supply of table eggs. This fully integrated business model provides flexibility, synergies and resilience through economic cycles. The presence across the entire poultry production value chain offers the option of selling DOCs at any stage in the production given the right market price. Conversely, DOCs can be kept till broiler stage of further downstream to food processing.

□ Economies of scale

The group is the largest integrated poultry producer in Malaysia and among the top three in Indonesia and Vietnam. With an annual production of 495mil DOCs, 99mil broiler chickens, close to 2mil MT of livestock feed and more than 1.7bil eggs, LHI has the scale which provides advantage over smaller players across the value chain such as bargaining power, outsourcing of raw materials and the production and distribution of poultry and livestock feed. Furthermore, LHI can replicate and expand its business in new markets to gain market share.

□ Riding on fast-growing food demand in Asean

LHI is operating in the Asean consumer market with significant growth potential. Asean has the third largest population in the world after China and India with a total of 650mil people as of 2018 and International Monetary Fund (IMF) projects it to reach 666.2mil in 2020. According to research conducted by Frost and Sullivan, poultry meat consumption is expected to grow by 9.1% CAGR from 2017 to 2020 in Indonesia while 3.2% CAGR in Malaysia for the same period. The Philippines and Vietnam are expected to register healthy growth at 6.6% and 5.2% CAGR from 2017 to 2020 respectively. Food producers will need to increase their output to feed the growing population. Backed by its huge scale, fully integrated model and wide network, LHI is well positioned to expand its business across the region.

□ Integrating downstream food processing operations of Malaysia and Singapore

Malaysia and Singapore are considered more matured for LHI compared with other regional countries whereby the group has established a strong market position. LHI will continue to grow the Malaysia and Singapore business by improving efficiencies, adding capacity and product innovations. Riding on the growing QSR market, the group will integrate its downstream food processing operations of Malaysia and Singapore for better economies of scale; and at the same time introduce more value-added downstream products to fulfil market needs.

□ Expansion plans

LHI has provided detailed expansion plans (Exhibit 13) for its feed mills and livestock businesses in Malaysia, Vietnam and the Philippines to drive its future earnings.

EXHIBIT 13: EXPANSION PLANS FOR MALAYSIA, VIETNAM AND THE PHILIPPINES

Expansion plan	Expected additional capacity per annum	Estimated date of construction	Estimated date of completion	Estimated capex
Malaysia				
32 closed-house broiler arms in Negeri Sembilan (7), Melaka (2), Perak (11), and Johor (12)	10.4mil broilers per annum	1Q2019	4Q2020	RM80mil for the next 24 months.
Vietnam				
Dong Nai feed mill expansion	285,120MT of livestock feed	1Q2018	Commenced operation in 1Q2019	RM150mil for the next 24 months
3 rd palleting line at Dong Nai feed mill	142,500MT of livestock feed	3Q2019	4Q2019	
Silo and soybean meal flat warehouse discharging system for storing raw materials on the existing land of Bau Bang, Dong Nai and Tien Giang feed mills	10,000MT of grain storage capacity	2Q2020	3Q2020	
Spent grain drying facility and centralise premix machinery in Dong Nai feed plant	13,200MT of spent grain drying & 24,000MT of centralise premix	2Q2019	1Q2021	
Aquaculture feed mill on 10-acre land in southern Vietnam (land acquisition in progress and expected to be completed in 1Q2020)	77,760MT of aquaculture feed	1Q2020	1Q2021	
Animal medicine injection line at Bau Bang feed mill plant	4,800 litres liquid medicines for animals	3Q2019	1Q2020	
3 PS closed-house farms and machinery in the existing Dong Nai farm	2.7mil broiler DOCs	1Q2019	3Q2019	
Installation and fitting of equipment in new Layer farms to be rented in Southern Vietnam, in particular in Binh Duong or Dong Nai provinces	168.2mil eggs	1Q2019	4Q2019	
Philippines				
First feed mill in Central Luzon	240,000MT of livestock feed	1Q2019	2Q2020	RM120mil for the next 24 months
A new GPS farm consists of 5 closed-house farms on an approx. 35-acre agricultural land in South Luzon	20,000 GPS DOCs	1Q2019	2Q2020	
A new PS farm consists of 12 closed-house farms on an approx. 23-acre plot of agricultural land in Central Luzon	93,000 PS DOCs	2Q2019	3Q2020	
2 new broiler farms which will consist of 16 closed-house farms on an approx. 38-acre plot of agricultural land in Central Luzon	3.36mil broiler DOCs	1Q2019	4Q2019	
A new hatchery building on an approx. 5-acre plot of agricultural land in Brgy. San Juan, Central Luzon. The hatchery building has a built-up area of 64,000 sq. ft. which can house 36 incubators	47mil eggs	4Q2018	2Q2019	

Source: AmInvestment Bank Bhd, Company

❑ **Experienced and hands-on management team**

LHI has more than 10,000 employees comprising over 7,600 permanent employees and more than 2,700 contract/temporary employees, led by Tan Sri Lau Tuang Nguang who is the group chief executive officer.

❑ **Dividend policy**

Management is targeting a payout ratio of approx. 30% from the group's PATMI each year.

EXHIBIT 14: KEY SENIOR MANAGEMENT PERSONNEL

Position	Name	Highlights of career
Group chief executive officer (CEO)	Tan Sri Lau Tuang Nguang	Tan Sri Lau Tuang Nguang has more than 35 years of experience and expertise in integrated livestock industry. He oversees the entire business operations of the group covering Malaysia, Singapore, Indonesia, Vietnam and the Philippines. He served as a panel advisor to the Ministry of Agriculture and Agro-based Industry Malaysia in 2004 and currently sits on the panel of the National Agriculture Advisory Council to the Ministry of Agriculture and Agro-based Industry.
Group breeder CEO	Lau Jui Peng	Graduated in 1996 with a Bachelor's degree in Business Administration from the Hawaii Pacific University, USA. He has approx. 19 years of experience and expertise in the production processes and management of poultry companies. He was appointed as non-executive chairman of Teo Seng Capital Bhd in 2008 and was redesignated as the executive chairman, a position he has held since 2013.
CEO of the group's Philippine operations	Lau Joo Heng	Graduated from Western Michigan University, United States with a Bachelor and Master's degree in Finance in 1996 and 1998 respectively. He has 15 years of experience in the operational activities of integrated livestock industry and exposure in retail and export businesses. Lau Joo Heng was the CEO of The Baker's Cottage Sdn Bhd (TBC) in 2003. He held positions at various management levels in the family business and the subsidiaries. He then left TBC to join the group's livestock business in 2015 and expanded the livestock business to the Philippines.
CEO of the group's Singapore operations	Lau Joo Hwa	Graduated from Victoria University of Melbourne, Australia in 2002 with a Bachelor's degree in Business. He has approx. 16 years of experience in the operational activities of integrated livestock industry and exposure in retail and export businesses. Lau Joo Hwa began his career in 2002 as a marketing manager at Malindo Feedmill and was redesignated as its operational manager in 2008. He was promoted to deputy CEO of Malindo Feedmill in charge of marketing and overall administration. He was also appointed the deputy CEO of KSB Distribution in 2014. He has been the CEO of the group's Singapore operations since 2017.
Executive director and CEO Vietnam operations	Lau Joo Hong	Lau Joo Hong has over 20 years of experience and expertise in the integrated livestock industry and retail market. He ventured into Vietnam's poultry business in 2007 and currently is the executive director and CEO Vietnam operations.
Country head of Indonesian operations	Lau Joo Keat	Graduated from Bachelor of Marketing from University of Kentucky, USA. Lau Joo Keat has 16 years of experience and expertise in the integrated livestock industry. He has served as a director of Malindo Feedmill since 2015 and is presently the group's Indonesian business since 2017.
CEO of Malaysian operations	Lau Joo Han	Graduated with a degree in International Trade from Victoria University, Melbourne, Australia in 1999. Lau Joo Han has He has over 19 years of experience in the livestock industry. He is a non-independent executive director and CEO for LHI's Malaysia operations.
Group chief financial officer	Chew Eng Loke	Chew Eng Loke holds a Bachelor of Economics in 1991 from Monash University, Australia and Master of Business Administration from University of Strathclyde, United Kingdom in 1998. He has over 25 years of experience in management and financial roles at numerous companies. Before joining LHI in 2015, he was the chief financial officer of AirAsia X Bhd.

Source: AmlInvestment Bank Bhd, Company

KEY RISKS FACTORS

□ *Requisite land use approvals and certificates of completion*

Any breach of express conditions, land use and/or failure to obtain relevant certificate of fitness for occupation (CF), certificate of completion and compliance (CCC) and certificate of feasible function (SLF) may adversely affect the group's business, financial condition and result of operations.

□ *Approvals, licences and permits from regulatory authorities*

The group shall require and hold certain approvals, licences and permits issued by various government authorities and regulatory agencies in the countries where it operates and these certain approvals, licences and permits are essential for the conduct of its business. Failure to obtain these approvals, licences and permits will have significant negative impact in the group's business and financial conditions.

□ *Trademark licence agreement and the "LH" trademark may not be renewed*

LH Holdings Sdn Bhd is the registered owner of the "LH" trademark in Malaysia and Vietnam. The trademark licence agreement dated 1 Aug 2018 between LH Holdings and LHI had granted an exclusive license for an annual royalty fee of 0.02% of LHI's turnover to use the "LH" trademark on an exclusive basis worldwide for an initial period of 10 years from the date of agreement and renewable successive periods of 10 years each, subject to mutual agreement on the royalty fee and renewed terms. There is no assurance that LHI will be able to renew the trademark licence agreement at a commercially reasonable cost or at all which could have adverse effects on the group's business.

□ *Dependence on key senior management team*

The success of the group is heavily dependent on the continued service of its executive directors and key senior management team who have valuable experience in the business.

□ *Supply of genetics for DOC breeding business*

The quality of livestock depends on the supply of genetics for the GPS, mainly imported from Cobb and Aviagen. Disruption in the supplies of GPS DOCs will require development and adoption of new productivity guidelines and may have material adverse impact on the group's operation and financial position.

□ *Dependent on contract farmers*

As at 31 Oct 2018, LHI has approx. 656 contract farms in Malaysia, Indonesia, Vietnam and the Philippines which contributed approx. 10.1% to the group's FPE 31 Oct 2018 revenue. The agreements between the contract farmers and the group are short term, therefore termination or failure to renew such contracts may have material adverse impact on the group's operation and financial position.

□ *Currency exchange fluctuations*

The group is exposed to exchange rate fluctuations, particularly in the SGD, USD, IDR, VND and PHP. For hedging against the currency fluctuations, LHI uses forward exchange contracts for purchases denominated in USD.

□ *Outbreak of livestock diseases*

Outbreak of livestock diseases will have a negative impact on the group's operation and financial position. Avian influenza is highly contagious among birds and can cause sickness or death of birds. The major outbreak of H5N1 in 2004 and H7N9 in 2013 have affected the poultry industry in the region. Nonetheless, LHI has taken measures to ensure high hygiene standards to minimise the impact in the event of an outbreak of livestock diseases. Closed-house systems are used to integrate the cooling system, hygiene control, pest and pollution control and waste management to reduce the risk of infection.

FINANCIAL ANALYSIS AND FORECASTS

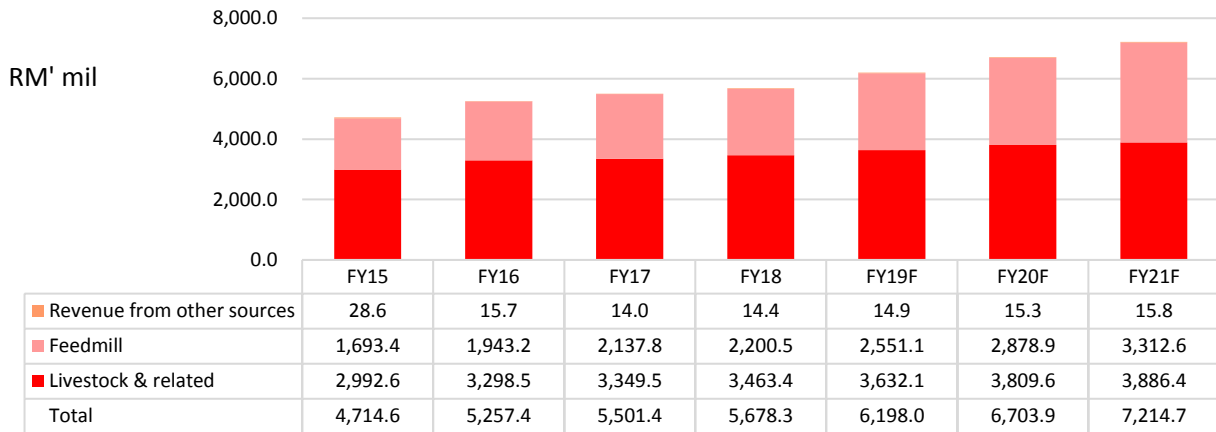
□ *Topline growth of 7.9% CAGR for FY19F-FY21F*

LHI's revenue grew by 4.6% and 4.5% YoY for FY17 and FY18 respectively, mainly driven by expansion in Vietnam's feed mills and growing livestock business in Indonesia and Vietnam.

The key factors to drive the group's revenue going forward are growing feed mill and livestock operations in Vietnam in particular and penetration into the Philippine market.

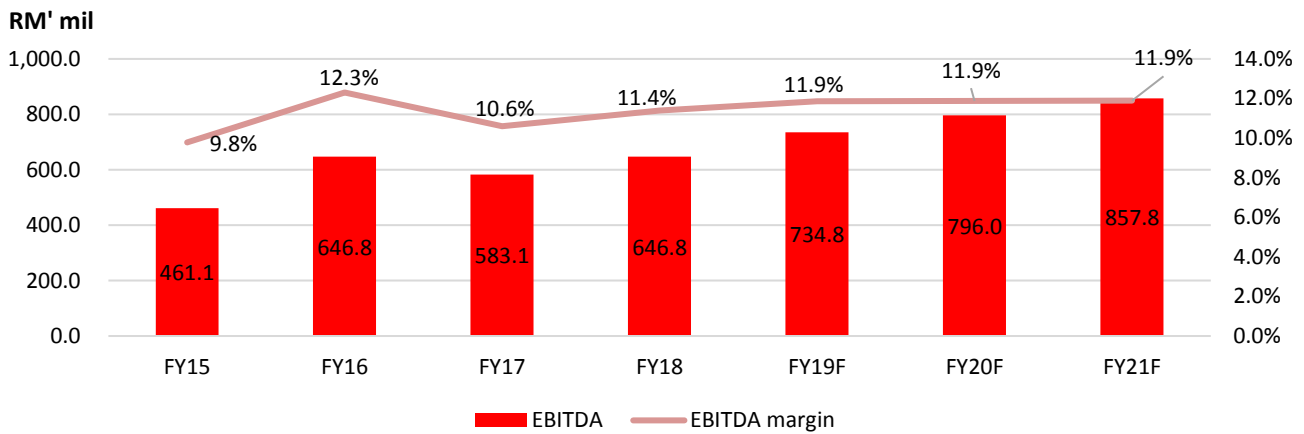
We project revenue to grow by 7.9%, 8.2% and 7.6% YoY for FY19F, FY20F and FY21F respectively (3-year CAGR of 7.9%) mainly driven by: (i) expansion feed mill in Vietnam; (ii) new aquaculture feed mill; (iii) expansion of PS closed-house farms and construction of a new layer farms in Vietnam; (iv) expansion of livestock farms and hatcheries in Malaysia; (v) a new feed mill in the Philippines; and (vi) new livestock farms and hatcheries in the Philippines.

EXHIBIT 15: REVENUE TREND



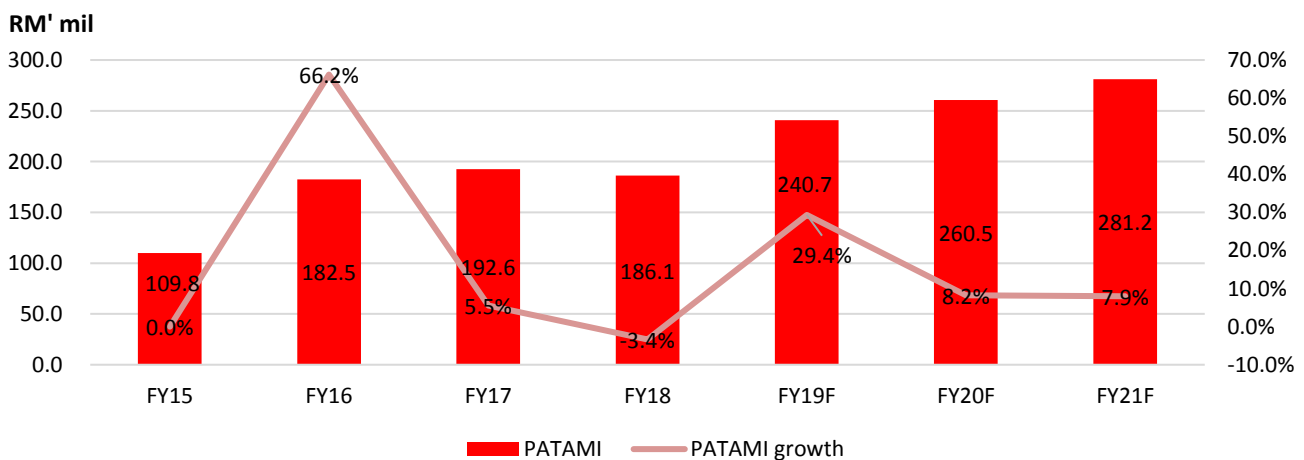
Source: AmlInvestment Bank Bhd, Company data

EXHIBIT 16: EBITDA AND EBITDA MARGINS



Source: AmlInvestment Bank Bhd, Company data

EXHIBIT 17: PATAMI AND PATAMI GROWTHS



Source: AmlInvestment Bank Bhd, Company data

EBITDA and margins

The group's EBITDA fell to 10.6% in FY17 from 12.3% in FY16 despite a 4.6% increase in the topline. This was mainly due to higher cost of sales (COS) (approx. 9%) and the drop in ASP of egg in Vietnam (approx. 27%) in FY17. Nonetheless, ASP of livestock in Vietnam has stabilised since the beginning of 2018, while ASP of livestock in Malaysia and Indonesia has improved in the same period, hence EBITDA margin to improve to 11.3% for FY18.

For FY19–FY21, we project EBITDA margin to remain stable, at above 11.5%, mainly driven by the ramp-up in Vietnam's feed mill and improving livestock production in Malaysia, Indonesia and Vietnam.

PATAMI to grow by 29.4%, 8.2% and 7.8% in FY19F-FY21F

The group's FY15-FY18 PATAMI grew by 19.2% CAGR contributed by expansion in Vietnam's feed mills and growing livestock business in Indonesia and Vietnam. We forecast LHI's PATAMI to grow by 29.4%, 8.2% and 7.9% to RM240.7mil, 260.5mil and 281.2mil for FY19-FY21F respectively, representing a 3-year CAGR of 14.7%. This is in line with the revenue growth and stable EBITDA margins.

Meanwhile, LHI's effective tax rate will stay below the statutory rate given the tax incentives in Vietnam which will last for the next 5 years.

Balance sheet

LHI's net gearing increased to 1.45x as the end of FY18 from 1.4x in the previous year mainly due to its expansion programme. Meanwhile, interest coverage is manageable at above 4x. We expect the group's net gearing to reduce to 1.06x by end of FY19 following the utilisation of IPO proceeds.

VALUATION AND RECOMMENDATION

Initiate with BUY

We value LHI at **RM1.43 per share**, pegged on 20x PER over FY20 earnings which is at a discount to its regional peers' market cap weighted average of 23.4x FY20 earnings (Exhibit 18). We believe LHI's 20x valuation is justified given its significant regional presence, production scale and a clear expansion plan (Exhibit 13).

The stock offers a potential upside of more than 30% and dividend yield of 1.9%. We initiate coverage on LHI with a **BUY** recommendation. Our BUY recommendation is premised on the group's stable earnings from Malaysia and Singapore's business while regional expansion at Vietnam and the Philippines provides growth potentials.

EXHIBIT 18: REGIONAL PEERS COMPARISON (MARKET CAP HIGHER THAN RM1.5BIL)

Company	Principal activities	Market Cap (RM'mil)	Net earnings growth		FY0-FY2 CAGR	FY0	PER FY1	PER FY2
QL Resources Bhd	Marine Products Manufacturing; Integrated Livestock Farming; Palm Oil Activities	11,178.6	11.1%	10.4%	10.8%	49.7	44.7	40.5
Charoen Pokphand Indonesia PT	Breeding and cultivation of chicken and its processing. Preservation of chicken meat and beef, including cold storage units.	23,926.0	52.1%	12.6%	30.9%	30.8	20.3	18.0
Godrej Agrovet Ltd	Poultry processing, animal feed, oil palm plantations and agri inputs	5,752.8	8.3%	5.1%	6.7%	38.7	35.7	34.0
Japfa Comfeed Indonesia-Tbk PT	Manufacturing animal feed. Breeding of poultry. Aquaculture division include fish and shrimp feed manufacturing together with fish and shrimp farming. Cattle division includes vertically integrated businesses, such as beef cattle breeding, fattening and slaughtering, as well as value-added meat production.	5,595.0	59.3%	13.9%	34.7%	15.8	9.9	8.7
Jiangxi Huangshanghuang GR-A	Hatching, breeding, slaughter and processing of poultry, and manufacture of meat products and feeds.	4,020.6	176.9%	27.8%	88.1%	74.9	27.0	21.2
Henan Huaying Agricultural Development Co Ltd:	Manufacturing animal feed. Produce and sell swine feed, chicken feed and other products.	2,165.7	21.0%	21.7%	21.4%	27.4	22.7	18.6
Thaifoods Group Public Company Limited	Produce and sell frozen and chilled chicken products primarily in Thailand and Vietnam. The company offers broiler chicks, layer chicks and layer chicken.	2,708.1	-42.6%	60.3%	-4.1%	13.7	23.8	14.8
Simple average						35.8	26.3	22.3
Market cap weighted average						36.2	26.5	23.4

Source: Bloomberg/ AmlInvestment Bank Bhd estimates

EXHIBIT 19: FINANCIAL DATA

Income Statement (RMmil, YE 31 Dec)	FY17	FY18	FY19F	FY20F	FY21F
Revenue	5,501.4	5,746.6	6,198.0	6,703.9	7,214.7
EBITDA	583.1	646.8	734.8	796.0	857.8
Depreciation/Amortisation	(199.1)	(189.9)	(204.8)	(221.6)	(238.4)
Operating income (EBIT)	384.0	456.9	530.0	574.5	619.3
Other income & associates	0.5	0.6	0.6	0.7	0.7
Net interest	(92.2)	(108.9)	(118.1)	(128.8)	(138.6)
Exceptional items	0.0	0.0	0.0	0.0	0.0
Pretax profit	292.3	348.6	412.5	446.4	481.4
Taxation	(44.9)	(101.8)	(94.9)	(102.7)	(110.7)
Minority interests	(54.8)	(60.7)	(76.9)	(83.2)	(89.5)
Net profit	192.6	186.1	240.7	260.5	281.2
Core net profit	192.6	186.1	240.7	260.5	281.2
Balance Sheet (RMmil, YE 31 Dec)	FY17	FY18	FY19F	FY20F	FY21F
PPE	2,045.8	2,216.8	2,616.8	3,016.8	3,416.8
Intangible assets	106.5	97.3	97.3	97.3	97.3
Other long-term assets	258.6	261.2	261.2	261.2	261.2
Total non-current assets	2,410.9	2,575.3	2,975.3	3,375.3	3,775.3
Cash & equivalent	502.4	458.9	523.6	578.3	637.4
Inventories	516.8	575.6	616.3	653.7	713.3
Trade receivables	564.0	649.2	652.0	716.6	781.8
Other current assets	483.3	574.2	590.2	619.6	654.5
Total current assets	2,066.6	2,257.9	2,382.1	2,568.2	2,786.9
Trade payables	242.2	248.9	281.8	295.7	319.1
Short-term borrowings	1,419.1	1,326.6	1,592.6	1,756.7	1,933.9
Other current liabilities	279.0	309.3	312.1	315.3	318.5
Total current liabilities	1,940.3	1,884.8	2,186.6	2,367.7	2,571.4
Long-term borrowings	774.4	1,044.3	786.0	967.8	1,144.7
Other long-term liabilities	120.7	139.4	139.4	139.4	139.4
Total long-term liabilities	895.1	1,183.8	925.4	1,107.3	1,284.2
Shareholders' funds	1,185.6	1,301.8	1,745.3	1,927.7	2,124.5
Minority interests	456.4	463.6	500.0	540.8	582.0
BV/share (RM)	0.32	0.36	0.48	0.53	0.58
Cash Flow (RMmil, YE 31 Dec)	FY17	FY18	FY19F	FY20F	FY21F
Pretax profit	292.3	348.6	412.5	446.4	481.4
Depreciation/Amortisation	199.1	189.9	204.8	221.6	238.4
Net change in working capital	11.4	(241.8)	59.4	131.5	159.6
Others	21.6	52.5	(354.8)	(612.5)	(690.1)
Cash flow from operations	524.4	349.2	322.0	186.9	189.4
Capital expenditure	(336.1)	(423.0)	(400.0)	(400.0)	(400.0)
Net investments & sale of fixed assets	(32.6)	6.5	0.8	0.0	0.0
Others	2.1	37.9	0.0	0.0	0.0
Cash flow from investing	(366.7)	(378.6)	(399.2)	(400.0)	(400.0)
Debt raised/(repaid)	549.9	178.9	7.7	346.0	354.0
Equity raised/(repaid)	0.0	0.0	275.0	0.0	0.0
Dividends paid	(58.4)	(58.0)	(72.2)	(78.1)	(84.4)
Others	(563.4)	(127.8)	0.0	0.0	0.0
Cash flow from financing	(71.9)	(6.9)	210.4	267.8	269.7
Net cash flow	85.8	(36.2)	133.2	54.7	59.0
Adjustments	8.4	(0.8)	0.0	0.0	0.0
Net cash/(debt) b/f	333.2	427.4	390.4	523.6	578.3
Net cash/(debt) c/f	427.4	390.4	523.6	578.3	637.4
Key Ratios (YE31 Dec)	FY17	FY18	FY19F	FY20F	FY21F
Revenue growth (%)	4.6	4.5	7.9	8.2	7.6
EBITDA growth (%)	(9.8)	10.9	13.6	8.3	7.8
Pretax margin (%)	5.3	6.1	6.7	6.7	6.7
Net profit margin (%)	3.5	3.2	3.9	3.9	3.9
Interest cover (x)	4.2	4.2	4.5	4.5	4.5
Effective tax rate (%)	15.3	29.2	23.0	23.0	23.0
Dividend payout (%)	0.0	0.0	30.0	30.0	30.0
Receivable turnover (days)	37.4	41.2	38.4	39.0	39.6
Inventory turnover (days)	35.3	34.7	35.1	34.6	34.6
Payable turnover (days)	16.6	15.6	15.6	15.7	15.6

Source: AmlInvestment Bank Bhd estimates

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