

13 August 2019

Poultry | Food & Beverages Product

## Leong Hup International (LHIB MK)

**Buy** (Maintained)

### Sharp Price Fluctuations In 2Q19

Target Price (Return)	MYR1.36 (+60%)
Price:	MYR0.85
Market Cap:	USD742m
Avg Daily Turnover (MYR/USD)	10.0m/2.4m

- Maintain BUY with lower TP of MYR1.36 from MYR1.53, offering 60% upside, 2% yield.** LHI furnished a set of key operational statistics that we think will point towards soft 2Q19 results. The weak prices could be due to the strong market supply during the quarter, but we highlight prices have rebounded in 3Q19. We maintain our positive stance on LHI as we believe investors should be focused on the longer-term earnings prospects driven by capacity expansion and robust poultry consumption.
- Releasing 2Q19 operational statistics.** In an announcement to Bursa Malaysia, LHI provided a set of key operational statistics for 2Q19 and expects the weaker product prices to affect profitability significantly. Essentially, 2Q19 broiler day-old chicks (DOC) and broiler prices have declined by 38.6% and 14.7% YoY. On a brighter note, sales volumes (Figure 1) across its operating markets have continued to grow and product prices have rebounded strongly since the beginning of 3Q19.
- Sharp price fluctuations between quarters.** We believe the released statistics will mean soft 2Q19 results (to be announced on 29 Aug). Notably, we observed that the poultry prices did not pick up strongly in May/June as per usual despite the *Aidil Fitri* festival in early Jun 2019. This could be due to the strong market supply given the wet weather conditions and the ramp-up in production following the strong prices in 1Q19. Based on the product prices provided by the Department of Veterinary Services (DVS), 3Q19 (updated to end-July) broiler DOC and broiler prices have surged 30% from their 2Q19 average as demand-supply turns favourable, and hence we reckon that a structural oversupply situation is unlikely.
- Our FY19-21 net profit forecasts are lowered by 25.1%, 16.5% and 12.5%.** This is after we impute more realistic product price and margin assumptions into our earnings model. Correspondingly, our DCF-derived TP is trimmed to MYR1.36 (from MYR1.53), which implies 19.7x FY20F P/E.
- Hatch the eggs patiently.** Despite the incoming likely moderate 2Q19 results, we believe this could be already in the price following the 23% fall in share price since IPO. In addition, we believe the price fluctuations are inherent in the poultry industry and investors should be focused on the longer-term growth prospects of the company instead. This would be driven by capacity expansion across all its operating markets and the robust consumption of poultry products as the cheapest source of protein and its religious neutrality. A sharp 3Q19 earnings rebound would be a near-term catalyst.
- Risks to our recommendation include** unfavourable changes in regulatory policy and supply-demand dynamics.

#### Analyst

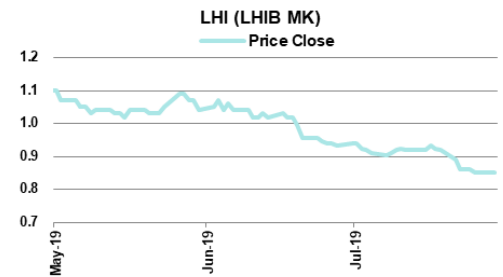
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#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	NA	(9.1)	NA	NA	NA
Relative	NA	(5.8)	NA	NA	NA

52-wk Price low/high (MYR)



Source: Bloomberg

Forecasts and Valuation	Dec-17	Dec-18	Dec-19F	Dec-20F	Dec-21F
Total turnover (MYRm)	5501	5747	6001	6502	7083
Net profit (MYRm)	185.0	219.0	201.2	252.2	295.5
Net profit growth (%)	(18.1)	18.4	(8.1)	25.3	17.2
Recurring EPS (MYR)	0.05	0.06	0.06	0.07	0.08
Recurring P/E (x)	16.8	14.2	15.4	12.3	10.5
P/B (x)	2.6	2.4	1.8	1.6	1.5
P/CF (x)	5.9	8.9	6.6	6.1	5.5
Dividend Yield (%)	1.2	1.9	1.9	2.4	2.9
EV/EBITDA (x)	10.2	9.5	7.9	7.0	6.3
Return on average equity (%)	15.4	17.6	13.3	14.0	14.8
Net debt to equity (%)	99.8	108.3	82.0	81.5	95.8

Source: Company data, RHB

## Financial Exhibits

Asia		<b>Financial summary</b>	<b>Dec-17</b>	<b>Dec-18</b>	<b>Dec-19F</b>	<b>Dec-20F</b>	<b>Dec-21F</b>
Malaysia		Recurring EPS (MYR)	0.05	0.06	0.06	0.07	0.08
Consumer Poultry		DPS (MYR)	0.01	0.02	0.02	0.02	0.02
<b>Leong Hup International</b>		BVPS (MYR)	0.32	0.36	0.47	0.52	0.58
		ROE (%)	15.4	17.6	13.3	14.0	14.8
<b>Major shareholders (%)</b>		<b>Valuation metrics</b>	<b>Dec-17</b>	<b>Dec-18</b>	<b>Dec-19F</b>	<b>Dec-20F</b>	<b>Dec-21F</b>
Emerging Glory	52.80	Recurring P/E (x)	16.8	14.2	15.4	12.3	10.5
Lau Family	9.70	P/B (x)	2.6	2.4	1.8	1.6	1.5
Clarinden Investments	7.96	FCF Yield (%)	6.5	0.9	3.1	4.7	7.1
<b>Valuation basis</b>		Dividend yield (%)	1.2	1.9	1.9	2.4	2.9
Discounted Cash Flow (WACC: 5.6%, TG: 2.0%)		EV/EBITDA (x)	8.9	8.4	7.9	7.0	6.3
		EV/EBIT (x)	13.5	12.0	11.8	10.4	9.4
<b>Key drivers</b>		<b>Income statement (MYRm)</b>	<b>Dec-17</b>	<b>Dec-18</b>	<b>Dec-19F</b>	<b>Dec-20F</b>	<b>Dec-21F</b>
i. Regional expansion plan;		Total turnover	5,501	5,747	6,001	6,502	7,083
ii. Favourable product prices.		Gross profit	913	1,034	1,037	1,127	1,226
		EBITDA	583	655	681	783	882
		Depreciation and amortisation	(199)	(197)	(227)	(256)	(287)
		Operating profit	384	457	455	527	596
		Interest expenses	(103)	(92)	(109)	(113)	(113)
		Income from associates & JVs	0	1	1	1	1
		Pre-tax profit	292	349	342	414	477
		Taxation	(45)	(102)	(75)	(91)	(105)
		Recurring net profit	185	219	201	252	296
<b>Key risks</b>		<b>Cash flow (MYRm)</b>	<b>Dec-17</b>	<b>Dec-18</b>	<b>Dec-19F</b>	<b>Dec-20F</b>	<b>Dec-21F</b>
i. Unfavourable change in regulatory policy;		Change in working capital	11	(242)	(69)	(116)	(135)
ii. Unfavourable demand-supply dynamics.		Cash flow from operations	524	349	471	505	566
		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)	(60)	(76)	(89)
		Cash flow from financing activities	(72)	(7)	(19)	(39)	(108)
		Cash at beginning of period	413	502	459	461	478
		Net change in cash	86	(36)	2	17	9
		Ending cash balance	502	459	461	478	486
<b>Company Profile</b>		<b>Balance sheet (MYRm)</b>	<b>Dec-17</b>	<b>Dec-18</b>	<b>Dec-19F</b>	<b>Dec-20F</b>	<b>Dec-21F</b>
LHI is on one of the largest fully-integrated producers of poultry, eggs, and livestock feeds in South-East Asia.		Total cash and equivalents	502	459	461	478	486
		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	5,138	5,486	5,818
		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	2,957	3,129	3,254
		Total equity	1,186	1,302	1,718	1,894	2,101
		Net debt	1,638	1,912	1,789	1,922	2,014
		Total liabilities & equity	4477	4834	5138	5486	5818
		<b>Key metrics</b>	<b>Dec-17</b>	<b>Dec-18</b>	<b>Dec-19F</b>	<b>Dec-20F</b>	<b>Dec-21F</b>
		Revenue growth (%)	4.6	4.5	4.4	8.3	8.9
		Recurring EPS growth (%)	(18.1)	18.4	(8.1)	25.3	17.2
		Gross margin (%)	16.6	18.0	17.3	17.3	17.3
		Ebitda margin (%)	10.6	11.4	11.4	12.0	12.5
		Operating margin (%)	7.0	8.0	7.6	8.1	8.4
		Recurring net profit margin (%)	3.4	3.8	3.4	3.9	4.2
		Capex/sales (%)	6.7	7.4	7.5	6.9	6.4
		Interest cover (x)	4.2	4.2	4.0	4.7	5.0

Source: Company data, RHB

Figure 1: Key operational statistics in 2Q19

	2Q19	2Q18	Change
<b>Product price in Malaysia (MYR)</b>			
Broiler day-old-chick (DOC)	1.21	1.97	-38.6%
Broiler chicken/kg	3.99	4.68	-14.7%
<b>Group sales volume (unit)</b>			
Livestock feed (MT)	583665	512436	13.9%
Broiler day-old-chick (DOC)	123	114	8.1%
Broiler chicken	31	28	10.7%
Eggs	430	406	5.9%

Source: Company, RHB

Figure 2: LHI's DCF valuation

FYE Dec	FY20F	FY21F	FY22F	FY23F	FY24F	FY25F	FY26F	FY26F	FY27F	FY28F
EBIT	527	596	640	662	689	715	732	755	781	812
EBIT*(1-tax rate)	411	465	499	516	538	558	571	589	609	633
Add: D&A	256	287	314	343	375	410	448	488	529	571
Less: WC investments (WC Inv)	-116	-135	-78	-96	-112	-115	-104	-120	-127	-139
Less: Fixed investments (FC Inv)	-450	-450	-500	-500	-600	-600	-700	-700	-700	-750
FCFF	101	166	236	264	201	253	215	257	311	315
Disc. FCFF	96	149	201	212	153	183	147	166	191	183
Terminal value at T=10	8969									
PV of terminal value	5207									
NPV	1681									
Less Debt	-1922									
Equity Value of Firm	4966									
Target Price	1.36									
Implied FY20F P/E	19.7									
Rf	3.8%									
Beta	0.96									
Risk premium	5.2%									
Rm	8.9%									
TG (%)	2.0%									
CoE	8.7%									
CoD	5.0%									
WACC	5.6%									

Source: RHB

<b>Buy:</b>	Share price may exceed 10% over the next 12 months
<b>Trading Buy:</b>	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
<b>Neutral:</b>	Share price may fall within the range of +/- 10% over the next 12 months
<b>Take Profit:</b>	Target price has been attained. Look to accumulate at lower levels
<b>Sell:</b>	Share price may fall by more than 10% over the next 12 months
<b>Not Rated:</b>	Stock is not within regular research coverage

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