

Consumer Sector

Overweight (ESG: ★★★)

Buy Poultry on Expectations of Higher ASP

(Maintained)

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The ex-farm value of Malaysian poultry industry has registered CAGR of 8.0% throughout 2011-2020 with a long-term poultry products' ASP growth of 2.5-4.5%. However, the growth was particularly dented in 2020 due to the outbreak of Covid-19, which disrupted the distribution network and triggered a plunge in ASP of poultry. That said, we reckon the dismal ASP environment would improve with firmer ASP going into 2021 correspond to commencement of Covid-19 vaccination programme and market consolidation. As such, we are confident about LHI and QL's CY21 earnings to surpass CY19, the pre-pandemic levels. Reiterate Buy on LHI and QL with respective target price of RM1.02/share and RM7.00/share.

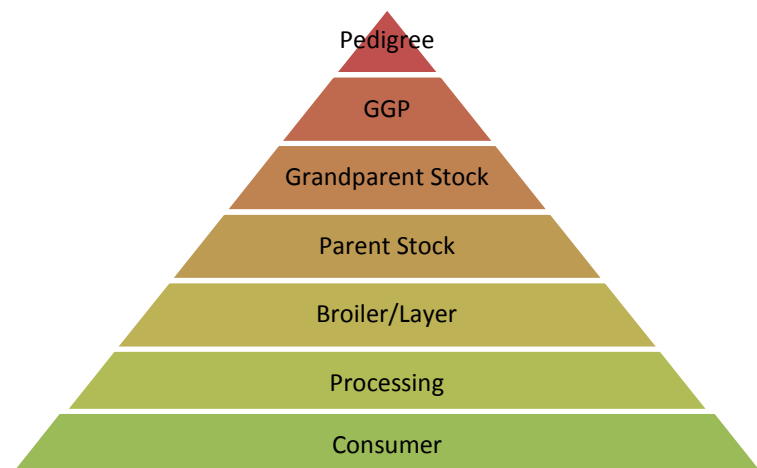
Which Came First: the Chicken or the Egg?

'Which came first: the chicken or the egg?', an ancient folk paradox, which was eventually answered scientifically in modern day according to evolutionary biology study stating that eggs came first after continuous evolution of species. Therefore, chickens had ancestors that were not exactly chickens. Having that aside, in this article, we would discuss about modern day poultry livestock farming, specifically chicken and table egg production in Malaysia, which has grown significantly owing to its importance as a source of cheap protein staples.

Operational Structure of Production

Broilers are raised for chicken meat whereas layers are raised for table egg production. Each of them has its own line of family tree, from pedigree, Great Grandparents (GGP), Grandparents Stock (GPS), Parents Stock (PS) to boilers/layers themselves. An integrated poultry player would extend its farms across several generations to maintain steady source of new breeder and broiler/layer alongside operate downstream plants to slaughter, process and/or package the poultry produce. For instance, Leong Hup International Berhad (LHI) being one of the largest ASEAN pure-play poultry players which commands one-fifth of Malaysian annual supply of day-old-chicks (DOC) operates GPS, PS and broiler/layer farms in Malaysia. Reference to Appendix 1 and Appendix 2, LHI is known to rear imported GPS broiler DOCs in its GPS farm to produce PS broiler DOCs, which is subsequently raised to produce broiler DOCs with the ultimate aim of being sold externally or retained internally as broiler for chicken meat production. Similarly, table egg production has comparable process with LHI importing PS layer DOCs.

Figure 1: Pedigree to the Consumers



Source: TA Research

A broiler DOC can achieve maturity quickly, in 5 to 7 weeks thus allowing a farmer to repeat the production cycle up to 7 times a year. That said, we reckon bottleneck/overhang of supplies may still happen occasionally as PS broiler DOC need to be raised for c.24 weeks before it starts to lay egg (meant to hatch broiler DOCs) for a duration up to c.42 weeks. Meanwhile, a layer DOC need to grow for c.16 weeks to become layer that is capable to lay eggs up to c.70 weeks.

Malaysian Poultry Industry Overview

The Malaysian ex-farm value of livestock has nearly doubled within the period of 2011-2020 to RM23bn. According to the Federation of Livestock Farmers' Associations of Malaysia (Figure 2), poultry meat and eggs are the top two contributors of livestock ex-farm value. When aggregated, the poultry industry registered a 2011-2020 CAGR of 8.0%, outgrowing the livestock industry growth of 7.8% and represent 74% of the total livestock ex-farm value.

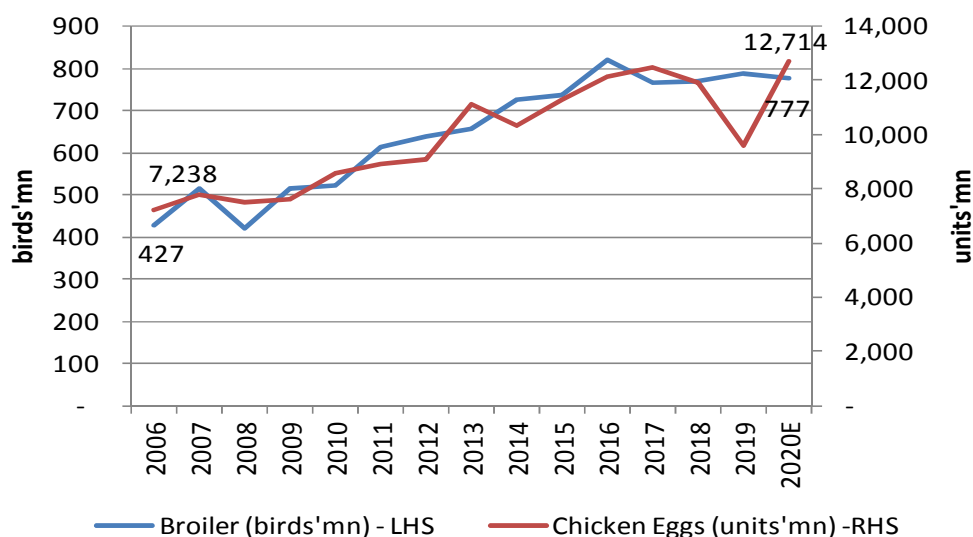
Figure 2: Ex-Farm Value of Livestock in Malaysia

Livestock Products	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020E
Beef	889	1,032	1,142	1,264	1,412	1,487	1,529	1,596	1,584	1,565
Mutton	78	146	151	149	145	166	168	173	168	161
Pork	2,047	1,969	2,049	2,402	2,526	2,370	3,243	3,888	4,041	4,033
Poultry Meat	5,950	6,868	7,414	8,499	9,534	10,776	10,884	11,694	11,685	11,568
Eggs	2,614	3,275	3,873	4,349	4,752	5,190	5,480	5,373	4,662	5,503
Milk	135	145	58	68	80	85	92	96	101	108
Raw Hides and Skins	12	12	12	14	17	18	20	20	20	19
Total	11,725	13,446	14,698	16,745	18,466	20,091	21,415	22,841	22,261	22,957

Source: FLFAM, TA Research

Poultry product is often seen as the go-to high protein product in Malaysia as it is nutritional, cheap in cost and accepted by all religions. The yearly poultry meat per capita consumption in Malaysia is over 50kg, higher than Singapore's c.35kg per capita and the ASEAN countries of c.15kg per capita. Nonetheless, the Malaysian poultry industry remains self-sufficient with production of chicken rising steadily across the year (as depicted in Figure 3) supported by improved technologies and management techniques such as closed-house system with automation alongside advancement in poultry genetics. Malaysian farmers were able to produce c.98% of the national demand for poultry meat and 115% of the national demand for chicken eggs. Among which, c.9% of chickens produced and c.17% of eggs produced is exported, giving farmers an additional sales channel. Majority of the exports are directed to Singapore.

Figure 3: Yearly Output of Broiler and Chicken Eggs in Peninsula Malaysia



Source: FLFAM, DVS, TA Research

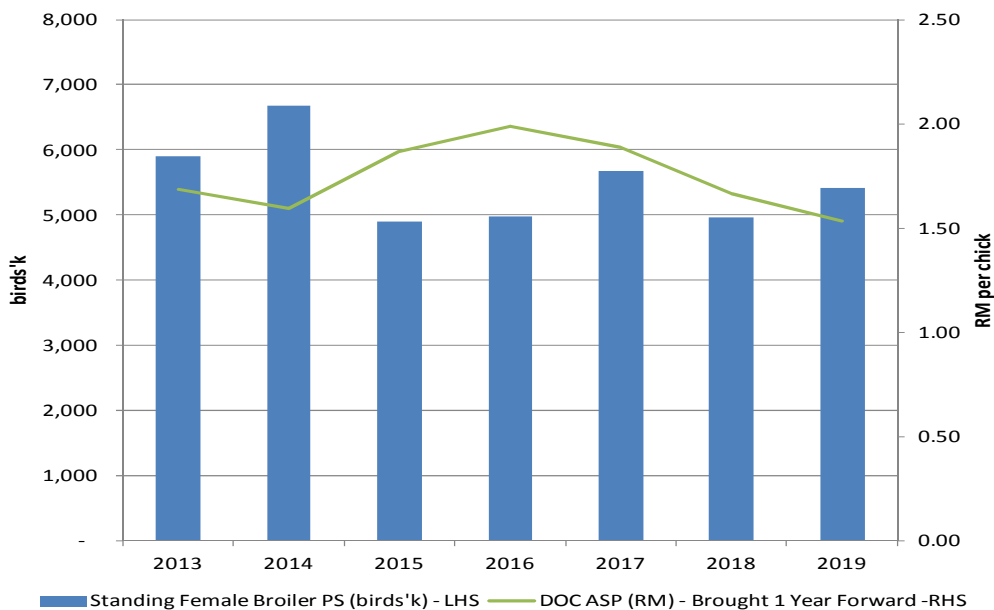
As for the local distribution, c.30% of the Malaysian broilers are directed to modern processing plants and subsequently sold in supermarkets and fast-food outlets whilst the balance is sold as live or dressed birds in the wet local markets.

Price Trend of Malaysian Poultry Industry

Given that chickens and eggs are largely homogenous, their average selling price (ASP) are often driven by short-term supply and demand, factoring supply chain disruption, seasonal productivity due to weather condition and temperature, in-home and out-of-home consumptions pattern, production cost alongside effect of festivity. For example, when weather is hotter, poultry specifically poultry grown in open-houses tends to grow at a slower rate, thus reducing the supply to the market, and therefore lead to an increasing ASP. Contrary is also true where cooler weather can speed up poultry growth and increase supply, thus result in lower ASP.

Moreover, there is an inverse relationship between the number of standing female broiler PS in Malaysia and ASP of DOC in the following year as depicted in Figure 4. Therefore, farmers often need to accounts for varying factors to project industry’s supply and manage their own production to maintain a healthy ASP trend. Although an accurate projection is difficult sometime, the market has the magical effect to normalise and revert to the equilibrium with farmer consolidating during bad times and entering during the profitable period. In the long term, data showed that Malaysian ASP of eggs, broilers and DOCs increased at an annual growth rate of 2.5-4.5% (after excluding the ASP shock in recent two years).

Figure 4: ASP of DOC against Standing Female Broiler PS



Source: FLFAM, DVS, TA Research

Covid-19 Impact and What to Expect Now

The outbreak of Covid-19 has adversely impacted the economy and poultry industry. The ASP of poultry product became extremely volatile as the distribution network was disrupted owing to widespread closures of HORECA channel, reduction in tourism and travel alongside absence of corporate events and large-sized gatherings. The CY20 ASP of broiler DOC dropped c.8% YoY whilst ASP of egg declined c.18% YoY.

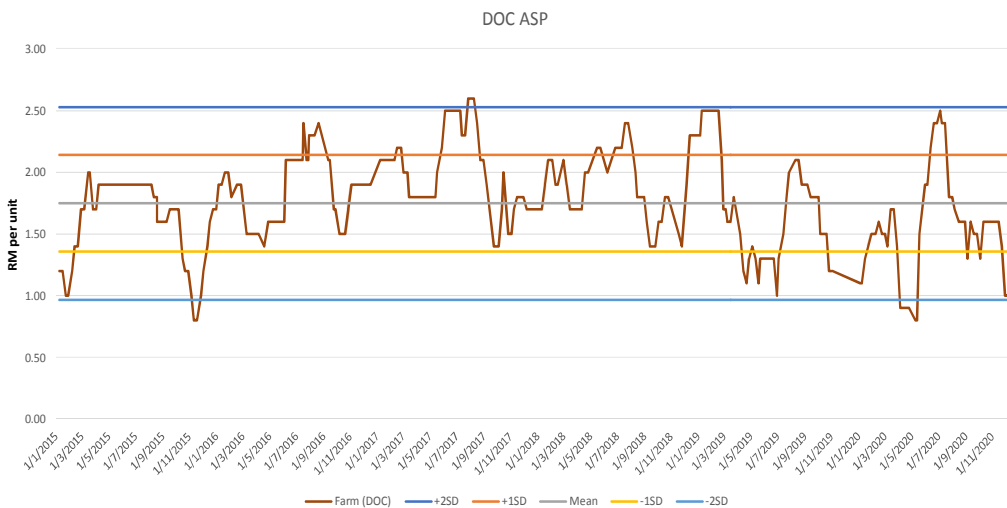
Based on a dataset aggregated by Google (refer to Appendix 3), which indicates the change in habits and mobility of Malaysian subsequent to the nationwide implementation of MCO since 18 March 2020, it is shown that recent mobility has begun to reverse towards the pre-pandemic level with visible improvement started since early-February 2021. According to the data, mobility in retail & recreation areas (restaurants, cafes, shopping malls and etc) recovered to negative 27%

from baseline, compared to approximately negative 50% previously in late-January 2021 whilst mobility in residential areas has reduced to positive 12% from baseline against approximately positive 30% in late-January-2021. We deem this as a sign that Malaysian are now getting more eager to resume their pre-pandemic activities whenever possible as the spike in mobility coincided with the more relaxed condition of movement order announced. Therefore, we reckon that the mobility toward retail & recreation areas would trend higher, possibly at an accelerated rate following successful rollout of Covid-19 vaccination programme.

For that reason, we believe the dismal ASP environment would improve with firmer ASP going into 2021 correspond to the commencement of Covid-19 vaccination programme, which would quicken the recovery in economic activities, including dine-in, corporate events, and private functions. Moreover, from the supply perspective, we reckon small farmers with weaker financial health would have exited during the unprofitable period. Statistically, the DOC and egg have also been trading at -1 and -2 standard deviation of 5-year mean for a prolonged period thus could be due for a mean reversion soon.

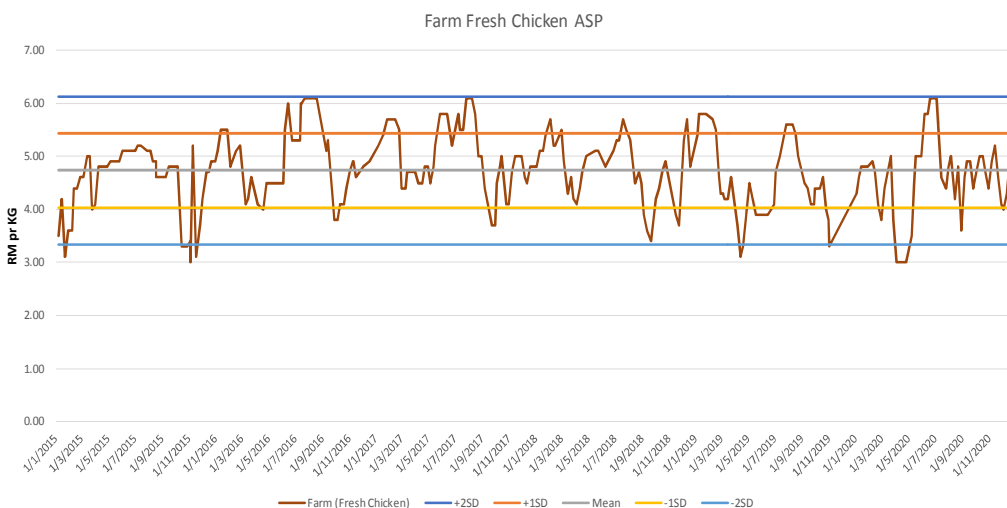
Based on channel check, we understand that ASPs of Malaysian DOC and broiler have shown uptick with ASP up double-digits from end-2020. However, ASP of Malaysian eggs remained low with the industry digesting through the initial shock from Singaporean ban on two Malaysian layer farms owing to presence of Salmonella Enteritidis.

Figure 5: DOC ASP Price Trend



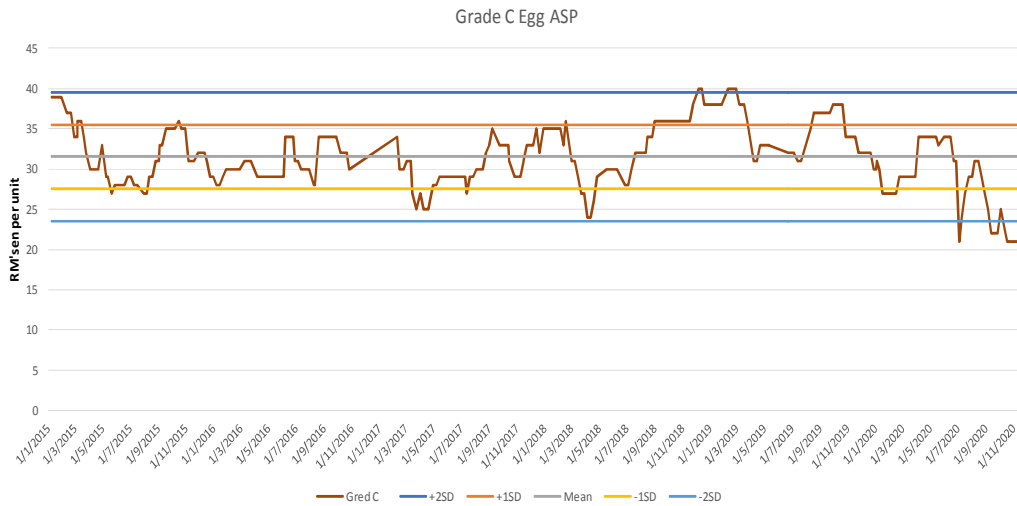
Source: DVS, TA Research

Figure 6: Farm Fresh Chicken ASP Price Trend



Source: DVS, TA Research

Figure 7: Grade C Egg ASP Price Trend

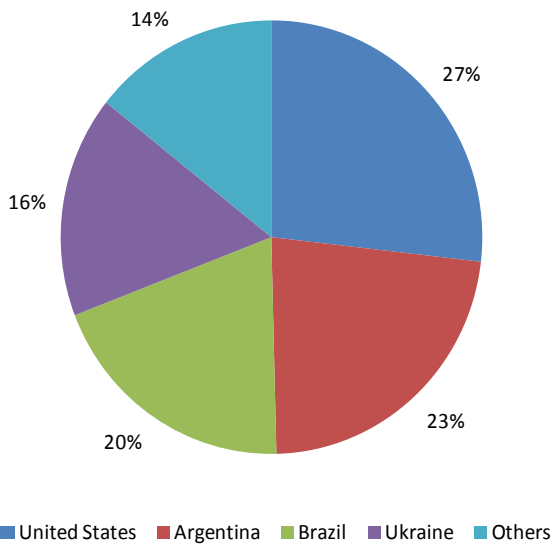


Source: DVS, TA Research

Trend of Feed Ingredients

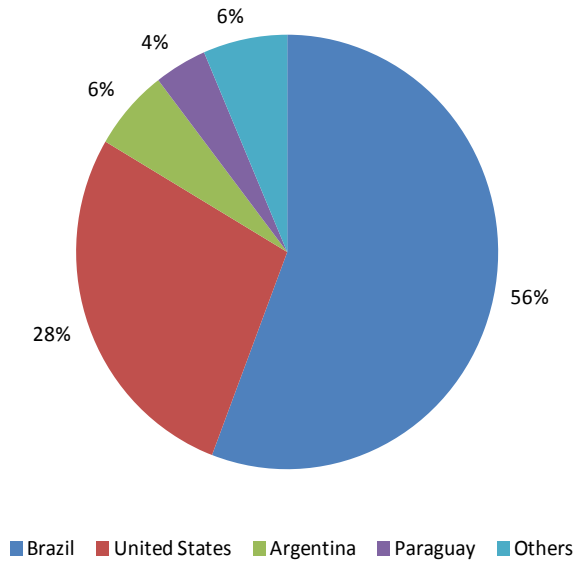
The key ingredients in livestock feed are corn and soybean meal, which form up to 80% of the feed volume and approximately 60-70% of feed cost, whilst remaining made up by vitamins and miscellaneous. Soybean meal is the by-product of the extraction of soybean oil from soybean. Typically, Malaysian poultry players would import corn and soybean meal from South America thus exposing them to foreign currency risk on top of commodity price risks that are inherent in the volatile corn and soybean markets. Note that, Argentina, Brazil and United States are the top 3 largest exporter of corn and soybean (depicted in Figure 8 and Figure 9).

Figure 8: Breakdown of World Corn Export as at 2020



Source: USDA, TA Research

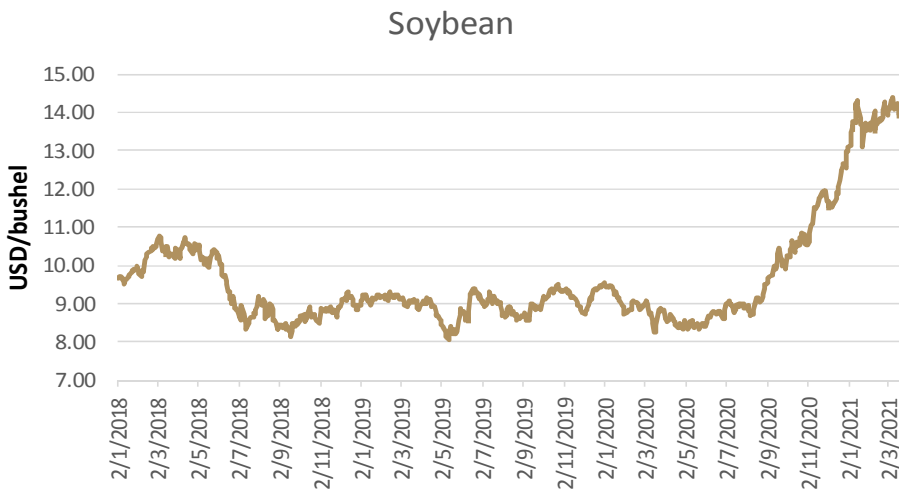
Figure 9: Breakdown of World Soybean Export as at 2020



Source: USDA, TA Research

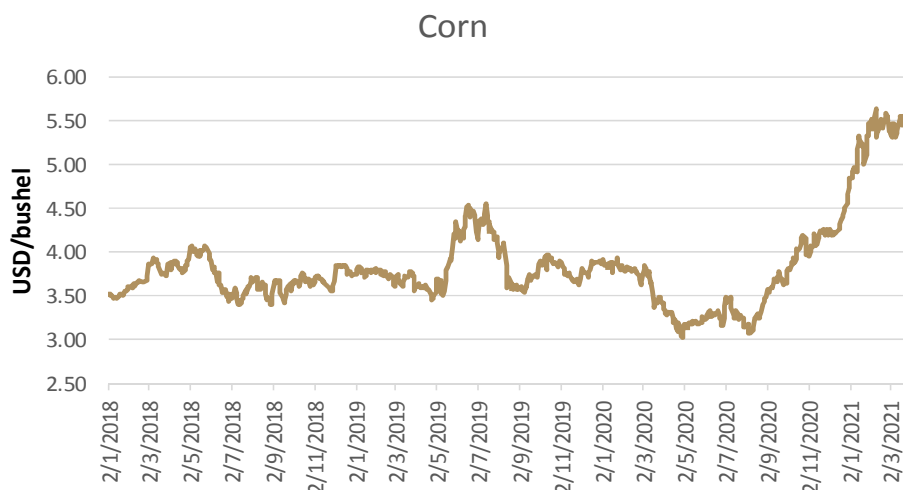
Global prices of soybean and corn have picked up strongly in late August-20. From September-20 to March-21, CBOT soybean has increased 35% YoY while CBOT corn recorded 22% YoY increase in price. The abrupt price increase was attributed to strong Chinese demand with imported corn primarily used to satisfy robust feed requirements in the swine sector. Reference to Figure 12, United States Department of Agriculture (USDA) projected China’s corn import for the 2021 periods at 24.0mn MT making China the largest corn importer by a sizable margin, followed by Mexico at 16.5mn MT and Japan at 15.6mn MT. Similarly, Chinese requirement for soybean is expected to remain elevated. From the export/supply perspective, global trade is expected to grow underpinned by significantly higher FY21 volume of United States corn and soybean exports (refer Figure 13 and Figure 14).

Figure 10: Price Trend of Soybean



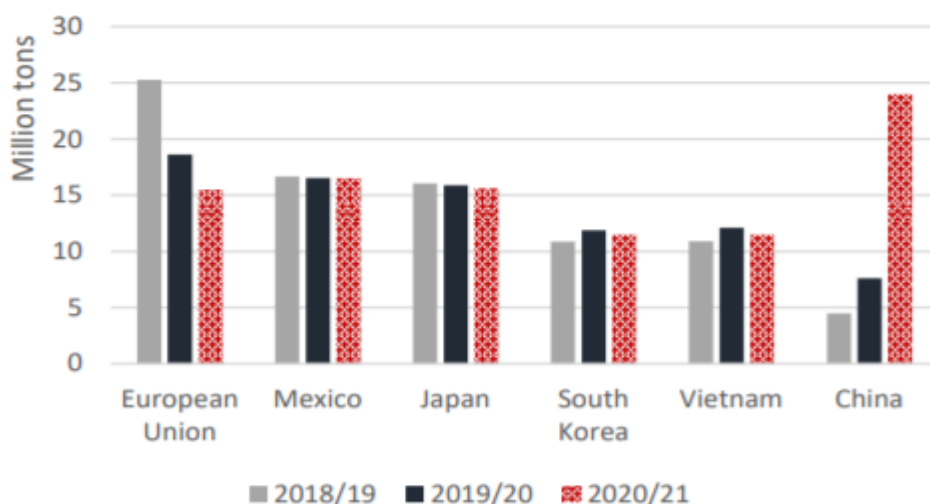
Source: Bloomberg, TA Research

Figure 11: Price Trend of Corn



Source: Bloomberg, TA Research

Figure 12: Top Importers of Corn



Source: USDA, TA Research

Figure 13: World Corn Export

World Corn Export (mn'MT)	2020	2021E
Argentina	39.9	32.0
Brazil	34.2	40.5
Burma	2.2	1.8
European Union	4.8	2.2
India	1.1	1.8
Paraguay	2.1	2.5
Russia	4.1	3.1
Serbia	3.1	3.5
South Africa	2.5	3.2
Ukraine	28.9	24.0
Others	5.2	5.5
United States	46.9	65.0
Total	175.0	185.1

Source: USDA, TA Research

Figure 14: World Soybean Export

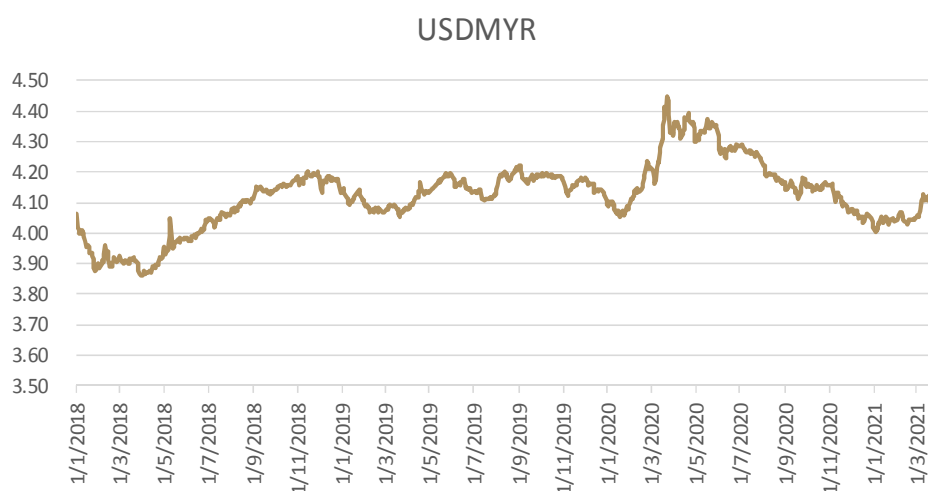
World Soybean Export (mn'MT)	2020	2021E
Argentina	10.0	7.0
Brazil	92.1	85.0
Canada	3.9	4.2
Paraguay	6.6	6.5
Others	6.7	5.8
United States	45.8	61.2
Total	165.2	169.7

Source: USDA, TA Research

Nonetheless, planting is underway in Argentina as well as Brazil and harvest is expected to come into the market by May/June, in which then could help to relieve the tightness of market supplies alongside moderate corn and soybean price downward. Besides that, USDA stated that United States' farmers are expected to increase corn and soybean planted acreage by c.5% in FY21, possibly making corn and soybean production to top their respective record annual production. Recall that United States registered record corn production of 15.2bn bushels or 384.8mn MT in 2016 and record soybean production of 4.4bn bushels or 120.5mn MT in 2018.

Meanwhile, USDMYR has dropped c.2% YoY during the September-20 to March-21 period in line with our in-house expectation that MYR would be stronger against USD in CY21. Generally, decline in USDMYR rate would provide marginal cost relief to importers such as the poultry player that import GPS/PS breeder and feed requirements.

Figure 15: Price Trend of USDMYR



Source: Bloomberg, TA Research

Overall, we reckon that the price of corn and soybean would begin to stabilize by mid-year as harvest from Argentina and Brazil comes into the markets. As for the aforementioned 35% YoY increase in soybean price and 22% YoY increase in corn price, we are not overly concerned as our back-of-envelope computation (refer to Figure 16) suggests that the double-digit increase in ASP of poultry products are sufficient in containing the higher commodity prices. Assumptions for the computation include:

- i) Cost of sales is 85% of revenue.
- ii) Feed cost makes up 60% of cost of sales with remaining from DOCs, labour and overhead.
- iii) Corn and soybean meal makes up 65% of feed cost with remaining from vitamins and other ingredients.
- iv) Equally weight the price change in corn and soybean and arrive to c.30% price increase in the aggregate.

Figure 16: Back-of-Envelope Cost Computation from Price Change of Corn & Soybean Meal

	RM
Revenue @ Broiler ASP of 4.20/kg	4.20
COGS to Revenue @ 85%	3.57
Feed Cost to COGS @ 60%	2.14
Cost of Corn & Soybean Meal to Feed Cost @ 65%	1.39
Absolute Incremental Cost from 30% Increase in Corn & Soybean Meal Price	0.42
% of ASP Increase Required to Pass-Through Incremental Cost	9.9%

Source: TA Research

Quality Control and Bio-Security

Quality control and bio-security is of fundamental importance to the continuing operation of poultry farming. Cognisant of such importance, large poultry players with deep financial pocket tend to embrace the more advanced closed-house system in poultry farming instead of utilising open-house system. This enables greater control over climatic factors such as temperature, humidity, air composition and light alongside hygiene factors in farm which improves growth and health of poultry. Moreover, farms have begun operating on an ‘all-in-all-out’ cyclical basis, with each farm being fully sanitised and left ‘offline’ for weeks during the transition period between a new and completed farming cycle to decrease the likelihood of poultry contacting diseases. As part of the efforts to enhance traceability, the large poultry players would tag each chicken with key identifying information prior to leaving farms to allow tracing of poultry produces back to a particular farm and a particular batch of poultry. This provides an effective feedback loop and enhances the need of responsible farming.

Flash Update on Salmonella Enteritidis

Salmonella Enteritidis (SE) is a form of bacteria that can cause foodborne illness in human and has occurred almost all over the world. SE bacteria typically live in animal intestines and are shed through faeces. Research says that there are two common routes of egg contamination by SE, which are by penetration through the eggshell from the colonized gut or from contaminated faeces during or after oviposition; and through direct contamination before oviposition, originating from the infection of hen’s reproductive organs with SE. Meanwhile, SE is unique in the way that it can be passed into the egg and multiply inside it without inducing noticeable changes. Consumers infected with SE may experience diarrhoea, fever, abdominal cramps, headache, nausea and vomiting.

On 12 March 2021, Singapore Food Agency (SFA) suspended one of Lay Hong Bhd’s layer farms in Jeram, Selangor from exporting eggs into Singapore following finding of SE on some of the eggs samples exported to Singapore. Instruction was then made to four Singaporean importers to recall eggs from aforementioned farm distributed in Singapore market. Subsequently, on 19 March 2021, SFA directed Singaporean importers to recall eggs imported from another Malaysian farm operated by Linggi Agriculture Sdn Bhd due to presence of SE. SFA informed that the affected eggs can be identified by the stamp “CEM014” on the egg.

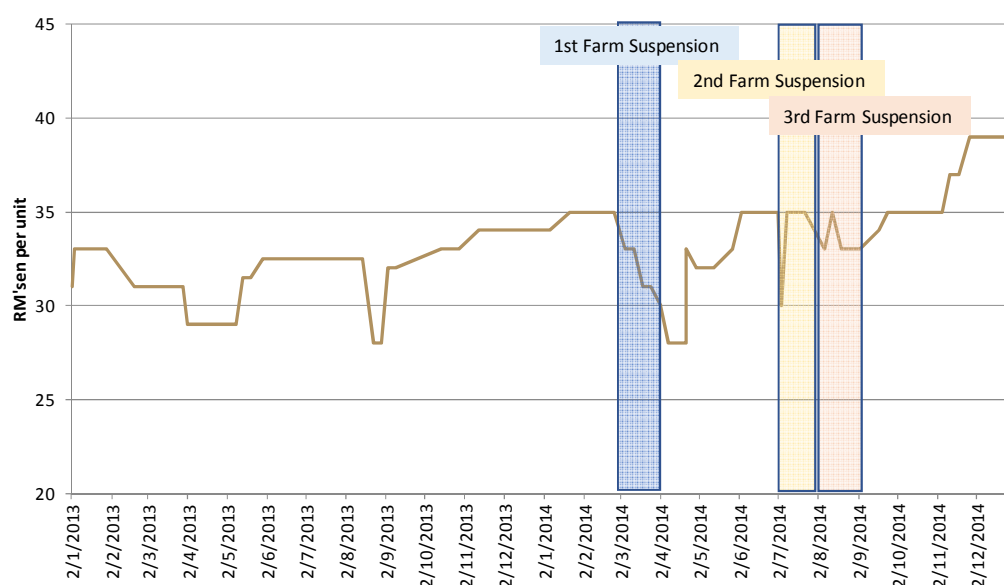
On 21 March 2021, Department of Veterinary Services (DVS) stated that their investigation and laboratory tests on samples taken from Jeram farm of Lay Hong have returned with negative results for the disease, proving that the farm is free from SE contamination. The comprehensive test was conducted with samples of eggs, environment chicken faeces, cloacal swab, feed, water and others from the farm.

Although SE contamination could happen at farm due to poor farming practices in terms of bio-security and hygiene. However, relating to the recent finding of SE in egg by SFA, DVS reckon that the contamination could have occurred along the egg marketing chain due to the unhygienic handling of eggs instead of the farm itself. Therefore, DVS is expected to initiate engagement with SFA over the matter following the negative results obtained on 21 March 2021. Meanwhile, DVS

said SE can be destroyed at temperatures above 71°C and consumers are advised to ensure that eggs purchased are clean, free of faecal contamination, stored in a suitable place and cooked properly before consumption.

Reviewing a precedent case back in 2014 where 3 farms owned by Charoen Pokphand Jaya, Chong Ne Nam and Teo Seng respectively were suspended by Singaporean authority for SE contamination, we found that ASP of Malaysian eggs nosedived immediately upon the news of first farm suspension by Singaporean authority. The environment in March-2014 is akin to current situation where ASP of Malaysian eggs plummeted owing to initial fear against purchasing and consuming eggs. That said, as consumers learnt that eggs available in the market (other than the one being investigated) are safe for consumption, demands for eggs recovered and have drove egg price up by over 10% YoY in 2HCY14 (Refer to Figure 17). Therefore, with number of Malaysian farms approved to export to Singapore now down to 19 farms from 21 previously, we do not discount that history may repeat itself in 2021.

Figure 17: Grade C Egg ASP During 2013 - 2014



Source: DVS, TA Research

Figure 18: Malaysian Layer Farm Approved to Export Eggs to Singapore

Farm Code	Farm Name	Farm Address	Farm Owner
1 CEJ014	Nong Shun Farm Sdn Bhd	Simpang Renggam, Johor	Nong Shun Farm
2 CEJ021	Premier Layer Sdn. Bhd.	Bukit Gambir, Ledang, Johor	Huat Lai
3 CEJ022	Henritex (M) Sdn Bhd	Simpang Renggam, Johor	Henritex
4 CEJ023	Teo Seng Layer Farm 2	Yong Peng, Johor	Teo Seng
5 CEJ024	Teo Seng Layer Farm 5	Yong Peng, Johor	Teo Seng
6 CEJ026	Teo Seng Layer Farm 9	Yong Peng, Johor	Teo Seng
7 CEJ027	Teo Seng Layer Farm 1	Yong Peng, Johor	Teo Seng
8 CEJ028	Teo Seng Layer Farm 10	Yong Peng, Johor	Teo Seng
9 CEJ029	Teo Seng Layer Farm 1B	Yong Peng, Johor	Teo Seng
10 CEJ030	Teo Seng Layer Farm 5B	Yong Peng, Johor	Teo Seng
11 CEJ032	PK Agro Desaru Layer Farm	Desaru, Kota Tinggi, Johor	Charoen Pokphand Malaysia
12 CEJ033	Teo Seng Layer Farm 13	Yong Peng, Johor	Teo Seng
13 CEM005	LTK (Melaka) Sdn Bhd	Durian Tunggal, Melaka	LTKM
14 CEM015	Chuan Hong Poultry Sdn Bhd (Farm A)	Alor Gajah, Melaka	Chuan Hong Poultry
15 CEM016	Huat Lai Agri Sdn Bhd (Farm C)	Bukit Lintang, Melaka	Huat Lai
16 CEM017	Selandar Farm	Selandar, Melaka.	Huat Lai
17 CEM018	HL Hitech (F2) Layer Farm	Serkam, Melaka	Huat Lai
18 CEM021	Chuan Hong Layer Farm C	Selandar, Melaka.	Chuan Hong Poultry
19 CEM022	Huat Lai Resources Bhd Farm B	Merimau, Melaka	Huat Lai

Source: SFA, TA Research

Governing Law and Regulation in Malaysian Poultry Industry

Malaysian poultry farming operators are regulated and are required to be licensed under specific laws of Malaysia. Some of the material governing law and regulation that are relevant include:

Poultry Farming Enactment that regulates poultry farming and its related activities such as the processing of poultry, poultry waste and poultry farm by-products. For instance, it is an offence under the enactment to discharge poultry waste irresponsibly, emission of unpleasant odours and/or fume alongside usage of banned drugs in poultry farms which may pose a hazard to the public.

Animal Act, 1953 governs the prevention of spreading diseases of animals and birds, licensing requirement for importation and exportation of animals and birds alongside the control of slaughtering of animals and birds in Peninsula Malaysia.

Feed Act, 2009 ensures that animal feeds are in good quality and safe by controlling importation, manufacture, sales and use of feed in Malaysia.

Food Hygiene Regulation, 2009 governs the hygiene and safety of food sold in Malaysia by ensuring food premises are hygienic and satisfactory in terms of design and building alongside ensuring personal hygiene are uphold to avoid practice that can contaminate food.

Poultry Player Under Our Coverage: LHI and QL

Under our coverage, LHI and QL Resources Bhd (QL) have significant exposures to the Malaysian livestock industry, specifically poultry farming. In FY20, LHI generated c.RM1.6bn of revenue (equivalent c.27% of group's revenue) via its Livestock and Poultry Related segment and Feedmill business. The company generated sales volume of 186mn DOCs, 59mn birds of broiler chicken, 1.44bn units of eggs (via its c.29% effective stake in Teo Seng Bhd) and 669kMT of livestock feed in Malaysia. Meanwhile, QL derived c.40% of the group's revenue through its broiler, layer, animal feed raw material trade and commercial feedmill business in Malaysia. The computation excluded its regional Integrated Livestock Farming business and the convenient stores contribution. In terms of volume, QL generated sales volume of 22mn DOCs, 19mn birds of broiler chicken, 1.46bn units of eggs and 1200kMT of animal raw material trade in Malaysia.

Figure 19: FY20 Malaysian Sales Volume of Poultry Products and Feed Trade

	LHI	QL
Broiler DOC (mn chicks)	186	22
Broiler Chicken (mn birds)	59	19
Egg (mn piece)	1438	1460
Livestock Feed/Raw Mat Trade (kMT)	669	1200

Source: Bloomberg, TA Research

During CY20, both LHI and QL were dragged by weak ASP of DOC and egg that have plagued the entire poultry industry. Fortunately, their integration into feedmill and raw material trading businesses has helped to partially cushion the shortfall. This was because feedmill and raw material trading businesses remained profitable during the period with healthy mark-up.

Business Plan of Large Poultry Player

Cost leadership and implementation of investment pacing plans would remain as the key strategies for both LHI and QL. The companies generally seek to increase volume to thrive for greater economies of scale and enhance level of automations in their respective facility to improve cost efficiency. Moreover, vertical integration is also important to better control margin alongside improve brand awareness. For instance, the rollout of The Baker Cottage across Peninsula Malaysia is aimed to increase the amount of chickens consumed and better manage margin of products within LHI's group of companies; whilst QL's Family Mart store may act as a distribution outlet for its eggs and surimi-based products.

Anticipate CY21 Earnings to Surpass Pre-Pandemic Level

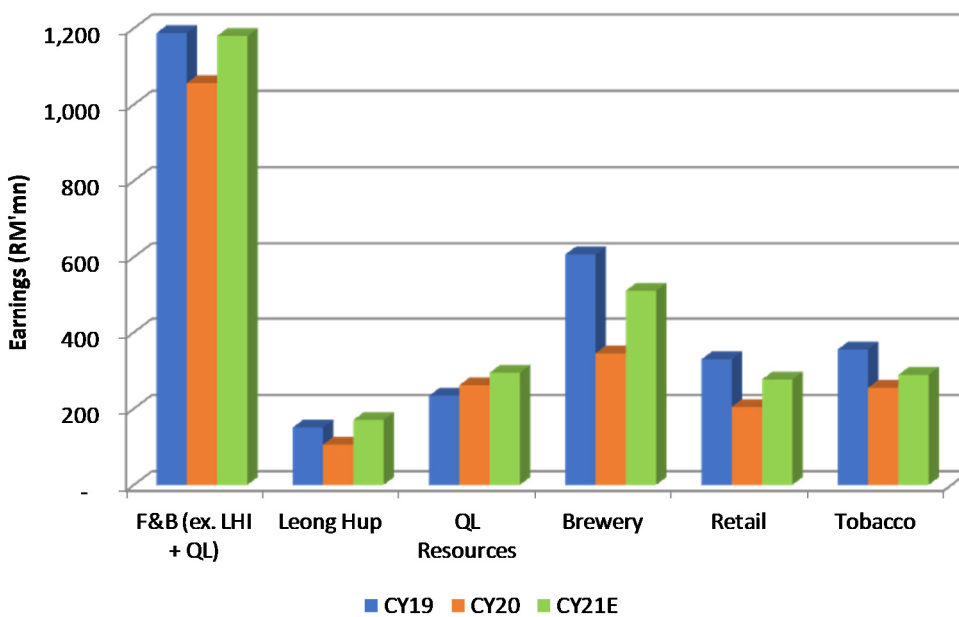
Moving into CY21, we believe LHI and QL would generate stronger earnings than CY19 or pre-pandemic levels. Our optimism over profitability of LHI and QL lies on the improvement in product’s ASP alongside volume growth driven by their continuing investment and market share expansion. An upswing of ASP would be a boon to earnings of poultry players given that ceteris paribus, the increase in ASP of livestock product flows directly to the bottomline. This is akin to the glove makers’ supernormal profit during ASP surge though on a smaller quantum given that government may opt to impose ceiling price on livestock product to ensure nation’s food prices remain well managed. Presently, the Malaysian government does set price ceiling over live chicken and egg during festive period to minimise profiteering activities. That said, we note that the ceiling price set are typically high and remain attractive for poultry players. For instance, during Hari Raya Aidilfitri 2020, government imposed a 14-days ceiling price of RM5.20/kg on live chicken and 36sen/piece on Grade A egg. These ceiling prices are significantly higher than CY20 average of RM4.65/kg and 33sen/piece respectively.

Based on our estimates, LHI and QL are anticipated to register CY21 YoY EPS growth of 61.2% and 12.6% respectively underpinned by an expansion in net profit margin of 0.8%-pts YoY (to 2.5%) and 0.2%-pts YoY (to 6.0%) respectively.

Superior CY21 YoY Growth against Consumer Peers

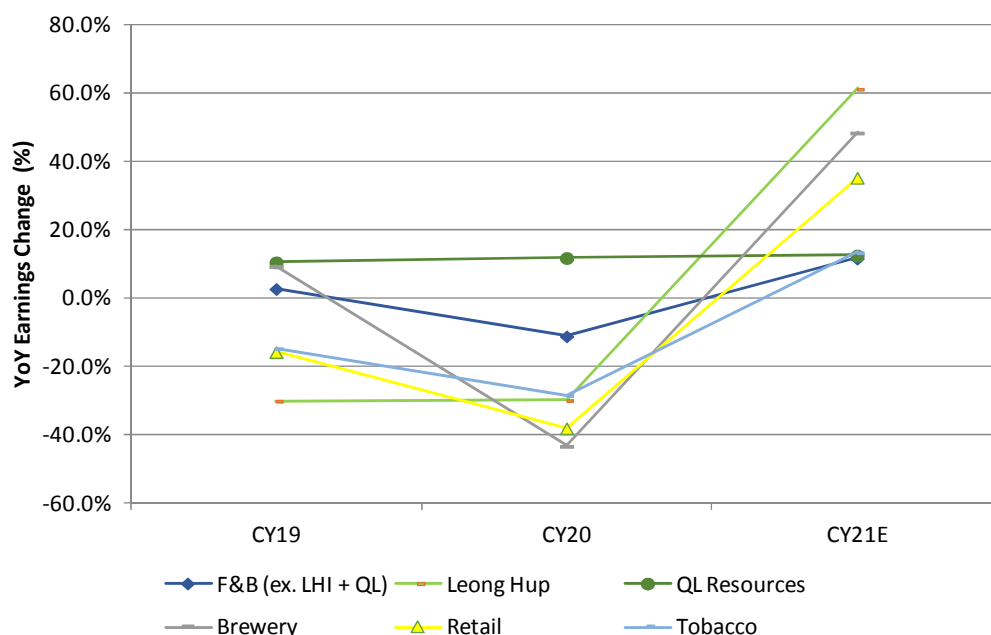
Looking at the bigger picture, earnings are expected to recover across all consumer sub-sectors with better control over the Covid-19 situation and dissipating fear against the pandemic. However, we believe that ability to surpass pre-pandemic earnings level is unique to the poultry players i.e. LHI and QL (refer to Figure 20). Furthermore, we expect LHI, the pure-play poultry player to register the highest YoY earnings growth, 61.2% in CY21, topping earnings growth of Brewery (48.4% YoY), Retail (35.3% YoY), Tobacco (13.4% YoY) and F&B sub-sector (11.7% YoY after excluding LHI and QL). Our confidence over earnings of poultry players is premised on the potential of riding the upswing in ASP in addition to volume growth compared to other sub-sectors which catalysts are largely confined to volume recovery.

Figure 20: LHI, QL and Consumer Sub-Sector FY19/20/21E Earnings



Source: Bloomberg, TA Research

Figure 21: LHI, QL and Consumer Sub-Sector FY19/20/21E YoY % Earnings Change



Source: Bloomberg, TA Research

To recap, Covid-19 and MCO have impacted companies across the Consumer sector.

Although **F&B players** were deemed part of the essential business and were allowed to operate, earnings was not left unscathed mainly due to sales contraction of dine-in channels as HORECA were particularly impacted by Covid-19 pandemic alongside higher Covid-19 related expenses to preserve employee's safety and operation continuity.

Brewers' CY20 earnings were crippled due to i) suspension of brewery plant from 18 March 2020 until 3 May 2020, ii) weaker on-trade sales due to prolonged control order and lower number of operating premises, alongside iii) dented tourism channel owing to international border restrictions.

Retailers that have dominant physical presence were negatively impacted by lower footfall during period of stringent movement restrictions and heightened consumers' fear against Covid-19 pandemic. In addition, physical stores that were deemed to be non-essential business were asked to close intermittently in compliance to government's orders. As a result, CY20 earnings slumped with some retailers recorded losses in months with prolonged stores closure.

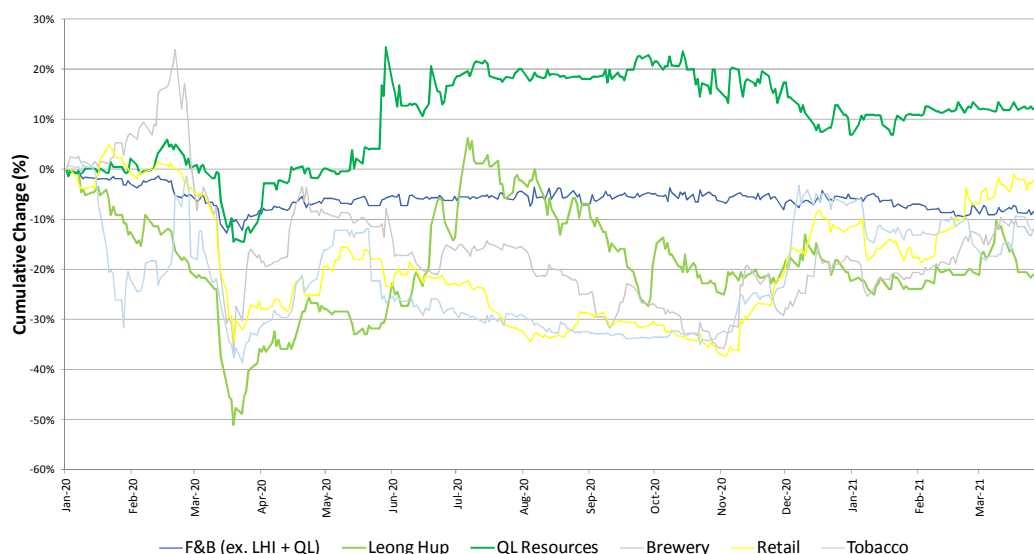
Tobacco player's earnings was negatively impacted by subdued duty-free sales (typically contribute c.4% of group's sales) as a result of border controls and continuing market downtrading. Moreover, a full-month of operational disruption in Apr-2020 due to government's order to temporary stop operation has also impaired the performance of tobacco player.

LHI's Earnings Growth Potentials Not Fully Factored into Price

Figure 22 illustrates change in market capitalization of LHI, QL and Consumer sub-sectors under our coverage from beginning of January-2020, which we deem as the baseline for pre-pandemic environment. The four Consumer sub-sectors are currently trading below their pre-pandemic level, with F&B (exclude LHI and QL), Brewery and Tobacco down 9%, 12% and 12% respectively; whilst Retail being the closest to the baseline, at -4%. We consider this reasonable given that investors weigh the potential recovery in future earnings against the still lacklustre performance (refer to Figure 20, forecasted earnings jumped but not back to pre-pandemic level) resulting in a single-digit to low-teen decline in market capitalisation from baseline.

Changing tune, the finding in Figure 22 also shows that LHI is the worst performer despite the expectation of FY21 earnings would surpass the pre-pandemic level. The market capitalisation of LHI is down 19% from baseline and we reckon this laggard, which is currently being under appreciated, has one of the highest capital gain potential among Consumer companies under coverage. In all, we believe market capitalisation of LHI should exceed if not be at par to the baseline given that FY21 earnings would likely surpass the pre-pandemic level. Meanwhile, QL, which operates a diverse agro-business, is one of the very few companies that have its market capitalisation higher than the pre-pandemic level. The group's ability to register resilient earnings from its diverse operations amid challenging times is a reflection of a strong management team, and strong management is often sought after by investors. During CY20 when economic weakness reared its head over Integrated Livestock Farming segment, QL's Marine Products Manufacturing segment managed to deliver remarkable performance, boosted by consumer's demands for surimi-based products, a popular ingredient of home-cooked meals.

Figure 22: LHI, QL and Consumer Sub-Sector % Change of Market Capitalisation from 2020



Source: Bloomberg, TA Research

Optimistic on Poultry Industry

We are positive that poultry players would enjoy firmer ASP and volume growth in CY21 with demand and supply dynamic turning favourable for the large poultry players. Thus, we believe LHI and QL would successfully capitalise on the upswing in ASP and register remarkable earnings in CY21, surpassing CY19 or the pre-pandemic level. Moreover, we find valuation of the companies, particularly LHI to be undemanding (traded at 12x CY22 EPS) at this juncture.

As such, we reiterate our Buy recommendation on LHI with a target price of RM1.02/share based on 18x FY22 EPS, along with a Buy recommendation on QL with a DCF valuation of RM7.00/share (k: 6.2%; g: 3.5%).

Figure 23: QL's DCF Valuation

DCF Valuation	
Rf	3.0%
Rm	9.0%
Beta	0.5
k	6.2%
Total NPV (RM'mn)	17,037.9
Share Outstanding (mn share)	2,433.7
FCFE/share	7.00

Source: TA Research

Figure 24: ESG Scoring – Leong Hup International

	Environmental	Social	Governance	Average
Scoring	★★★	★★★	★★★	★★★
Remark	Compliant towards waste management on both hazardous and non-hazardous waste. However, score is muted owing to absence of quantifiable goal for near future.	Farming and trading of poultry-related products helps to meet protein needs and encourage balance diet.	The board has decent gender diversity though is short of 1 independent director to meet the 50% majority. Leong Hup has targeted dividend payout of 30%.	

Source: Company, TA Research

Figure 25: ESG Scoring – QL Resources

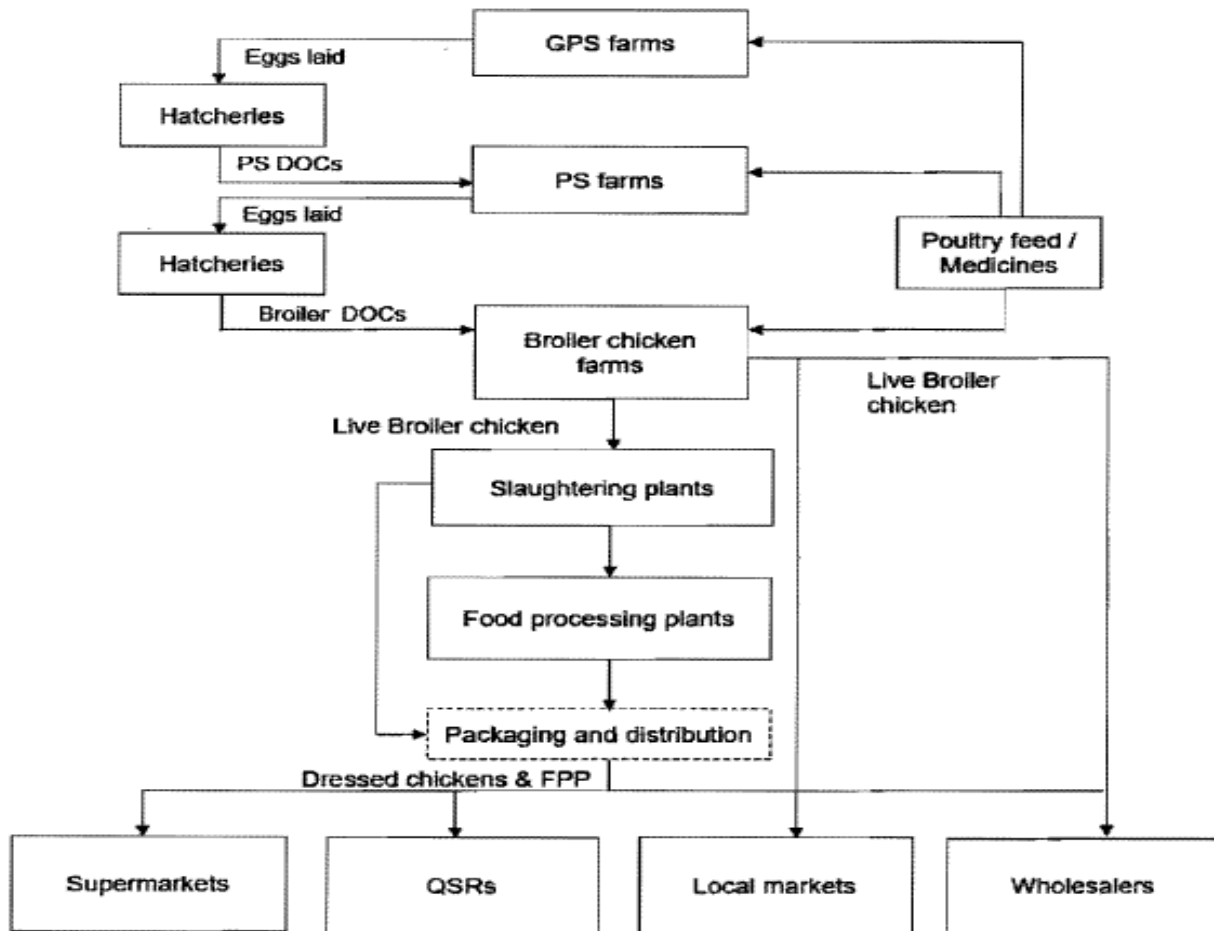
	Environmental	Social	Governance	Average
Scoring	★★★	★★★★	★★★★	★★★★
Remark	Visible efforts in tracking and managing wastes (hazardous waste, mixed papers, plastic, food waste, manure and metal scrap) and pursuing usage of renewable energy. However, score is muted owing to absence of quantifiable goal for near future.	Notable efforts in enriching communities, and has extensive training over OSHA alongside emphasis on safety. Prompt work restructuring amid unexpected major catastrophe.	The board is well represented by 55% independent directors and has decent gender diversity. QL has also been consistent in returning >30% of profit to shareholders.	

Source: Company, TA Research

Peers Comparison Valuation

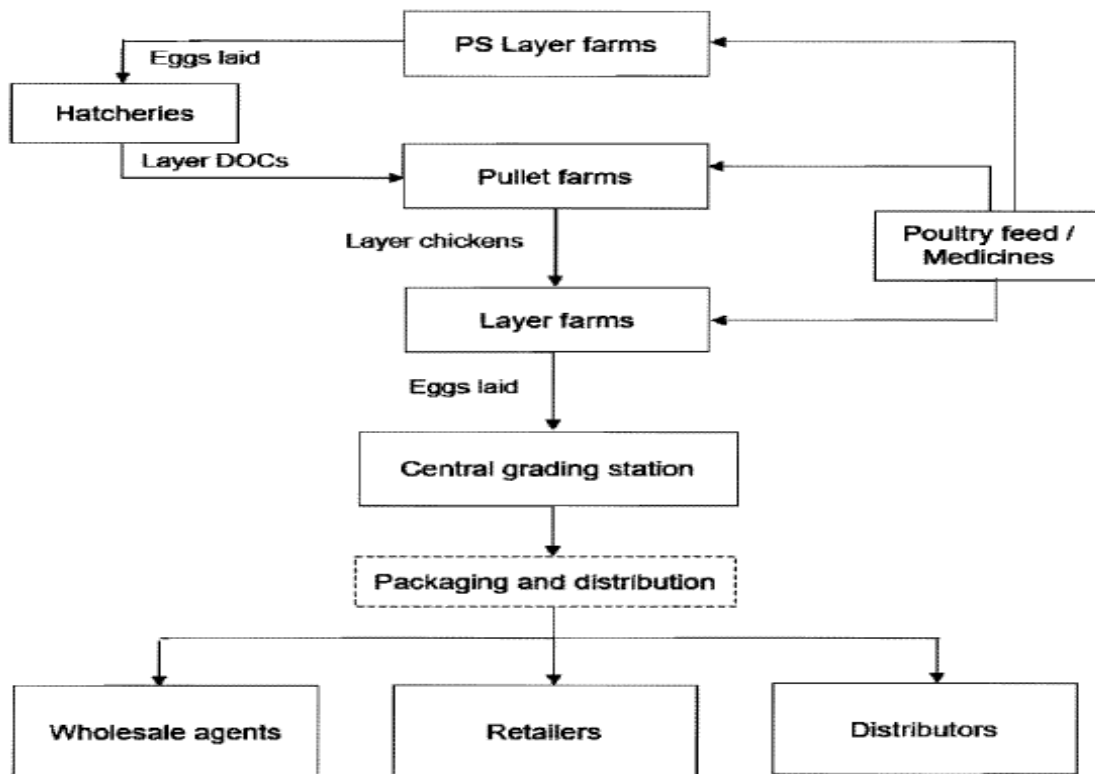
Company	Call	ESG	Price	Target Price	PER (x)		P/BV (x)		EPS Growth (%)		ROE (%)		Div Yield (%)	
					CY21	CY22	CY21	CY22	CY21	CY22	CY21	CY22	CY21	CY22
Brewery														
Carlsberg	Buy	★★★★	23.92	25.30	29.9	24.0	40.1	38.0	40.4	24.3	145.9	181.4	3.3	4.2
Heineken	Buy	★★★★	25.62	26.50	29.0	23.4	21.7	21.1	56.7	24.1	75.5	91.4	3.3	4.2
Retail														
Aeon	Buy	★★★	1.28	1.45	18.4	13.7	1.0	1.0	60.7	34.2	5.6	7.3	2.3	3.1
Amway	Sell	★★★	5.52	6.00	16.4	15.9	3.9	3.7	25.1	2.9	24.1	23.7	5.0	5.0
Padini	Buy	★★★	3.17	3.20	18.6	14.8	2.4	2.3	26.3	25.6	11.5	15.4	2.4	3.6
Focus Point	Sell	★★★	0.78	0.74	22.9	19.0	2.3	2.1	6.3	20.6	15.1	16.6	1.9	2.3
F&B														
Johore Tin	Buy	★★	1.69	2.30	12.3	9.8	1.4	1.3	5.7	25.5	11.6	13.6	3.7	4.4
Hup Seng	Sell	★★★	0.93	1.00	18.1	16.6	5.6	5.7	1.9	9.1	30.2	34.2	6.5	6.5
F&N	Buy	★★★★★	30.56	40.00	25.4	23.2	3.8	3.6	6.2	9.5	15.5	15.9	2.2	2.3
QL Resources	Buy	★★★★	6.06	7.00	50.1	43.6	6.0	5.5	12.6	15.0	12.7	13.1	0.6	0.6
Nestle	Sell	★★★★★	135.50	143.00	48.6	44.5	55.0	51.9	17.2	9.2	115.2	120.0	2.0	2.1
Leong Hup	Buy	★★★	0.70	1.02	14.9	12.3	1.0	1.0	61.2	21.2	9.6	10.8	2.0	2.4
Tobacco														
BAT	Buy	★★★★	13.74	15.70	13.6	13.3	10.1	9.7	13.4	2.3	75.7	74.3	6.9	7.1
Industrial														
Scientex	Buy	★★★	4.03	5.05	14.2	13.0	1.9	1.7	4.8	9.0	15.5	15.4	2.1	2.3
Signature	Buy	★★★	1.03	1.18	22.1	16.7	1.3	1.3	213.1	31.8	5.3	7.3	2.1	2.6
Poh Huat	Buy	★★	1.61	2.16	7.5	7.3	0.8	0.7	(1.8)	2.4	13.3	12.7	5.6	5.6

Appendix 1: LHI's Operational Structure of Chicken Production



Source: Company, TA Research

Appendix 2: LHI's Operational Structure of Egg Production



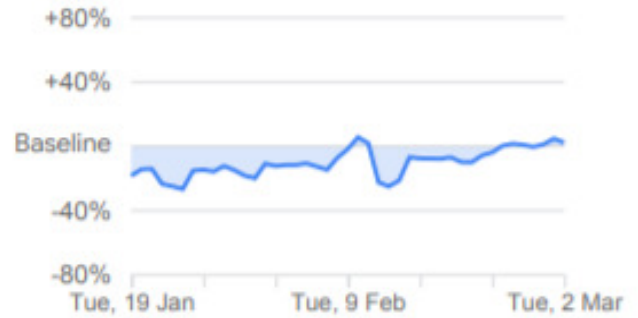
Source: Company, TA Research

Appendix 3: Malaysian Covid-19 Community Mobility Reports

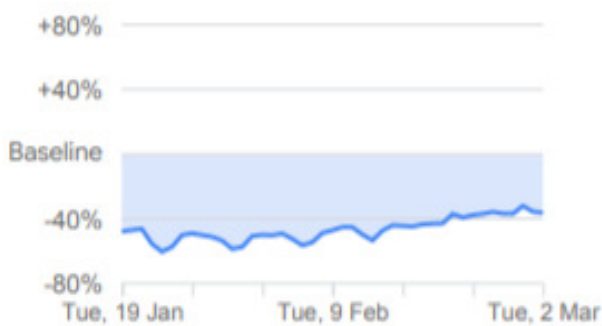
Retail & Recreation Mobility Recovered to -27%



Grocery & Pharmacy Mobility Eked Up +2%



Parks Mobility Recovered to -36%



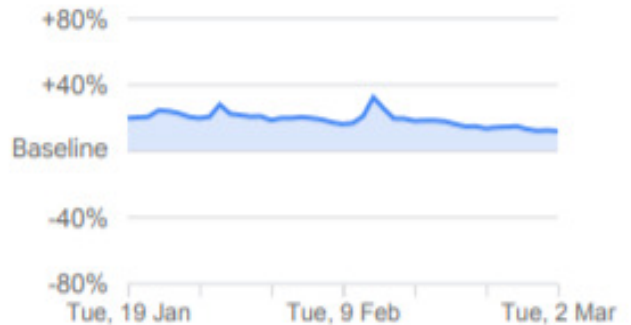
Transit Stations Mobility Recovered to -50%



Workplaces Mobility Recovered to -23%



Residential Mobility Reduced to +12%



Note: The baseline is the median value, during the 5- week period of Jan 3–Feb 6, 2020.

Source: Google, TA Research

Earnings Summary – Leong Hup International

Profit and Loss Statement

FYE 31 Dec (RMmn)	FY19	FY20	FY21E	FY22F	FY23F
Revenue	6,054.8	6,040.7	6,572.7	7,021.5	7,302.1
EBITDA	637.7	525.8	710.8	791.5	860.5
Depreciation	(225.5)	(259.4)	(288.2)	(304.4)	(320.8)
Net finance cost	(123.8)	(109.7)	(115.1)	(114.5)	(114.0)
Associate	0.4	0.4	0.4	0.5	0.5
EI	0.0	7.5	0.0	0.0	0.0
PBT	288.8	157.1	307.9	373.0	426.2
Taxation	(75.8)	(39.6)	(80.8)	(97.9)	(111.8)
MI	(62.4)	(4.4)	(56.8)	(68.8)	(78.6)
Net profit	150.6	113.1	170.3	206.4	235.8
Core net profit	150.6	105.7	170.3	206.4	235.8

Core EPS (sen)	4.1	2.9	4.7	5.7	6.5
Diluted EPS (sen)	4.1	2.9	4.7	5.7	6.5
DPS (sen)	1.6	0.6	1.4	1.7	1.9
Book Value (RM)	0.6	0.6	0.7	0.7	0.8
NTA (RM)	0.4	0.4	0.5	0.5	0.6

Ratios

FYE 31 Dec (RMmn)	FY19	FY20	FY21E	FY22F	FY23F
Valuations					
Core PER (x)	16.8	24.0	14.9	12.3	10.8
Div. Yield (%)	2.3	0.9	2.0	2.4	2.8
P/BV (x)	1.2	1.1	1.0	1.0	0.9

Profitability ratios

EBITDA margin (%)	10.5	8.6	10.8	11.3	11.8
PBT margin (%)	4.8	2.5	4.7	5.3	5.8
Core Net Margin (%)	2.5	1.7	2.6	2.9	3.2
Core ROE (%)	10.2	10.2	9.6	10.8	11.4
Core ROA (%)	2.9	3.1	2.9	3.5	3.8

Liquidity ratios

Current ratio (x)	1.2	1.1	1.1	1.1	1.2
Quick ratio (x)	0.9	0.8	0.8	0.8	0.8

Leverage ratios

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

Growth ratios

Revenue (%)	5.4	(0.2)	8.8	6.8	4.0
PBT (%)	(17.2)	(45.6)	96.0	21.2	14.3
Core Net Profit (%)	(30.0)	(29.8)	61.2	21.2	14.3

Balance Sheet

FYE 31 Dec (RMmn)	FY19	FY20	FY21E	FY22F	FY23F
PPE	2,396.5	2,656.5	2,798.3	2,927.5	3,055.8
Intangible Asset	97.5	95.3	95.3	95.3	95.3
Associate	1.6	1.6	1.6	1.7	1.7
Others	408.8	475.0	475.0	475.0	475.0
Non-current assets	2,904.3	3,228.4	3,370.3	3,499.5	3,627.9
Inventories	679.6	721.9	757.2	804.2	829.6
Trade receivables	499.3	489.6	540.2	577.1	600.2
Cash and Bank Balance	764.8	757.8	710.3	699.3	758.5
Others	561.1	497.2	497.2	497.2	497.2
Current assets	2,504.8	2,466.4	2,504.9	2,577.8	2,685.4
Total Assets	5,409.1	5,694.8	5,875.1	6,077.4	6,313.3
LT Borrowings	873.1	874.5	857.9	857.9	857.9
Others	252.1	279.9	279.9	279.9	279.9
Non-Current liabilities	1,125.2	1,154.4	1,137.8	1,137.8	1,137.8
Trade payables	273.1	229.4	292.0	289.2	289.9
ST Borrowings	1,508.7	1,764.8	1,731.4	1,731.4	1,731.4
Others	321.6	297.7	297.7	297.7	297.7
Current liabilities	2,103.4	2,291.9	2,321.0	2,318.3	2,318.9
Shareholders funds	1,641.2	1,713.4	1,832.7	1,977.1	2,142.2
MI	539.3	535.1	583.6	644.1	714.4
Total Equity	2,180.5	2,248.6	2,416.3	2,621.3	2,856.6
Total E&L	5,409.1	5,694.8	5,875.1	6,077.4	6,313.3

Cash Flow Statement

FYE 31 Dec (RMmn)	FY19	FY20	FY21E	FY22F	FY23F
Pretax profit	288.8	157.1	307.9	373.0	426.2
Depreciation	225.5	259.4	288.2	304.4	320.8
Net interest	123.8	109.7	115.1	114.5	114.0
Associates	(0.4)	(0.4)	(0.4)	(0.5)	(0.5)
Changes in WC	52.9	(67.1)	(23.3)	(86.7)	(47.8)
Tax	(57.0)	(55.3)	(80.8)	(97.9)	(111.8)
Others	37.1	26.0	0.0	0.0	0.0
Operational cash flow	670.6	429.4	606.7	607.0	700.9
Capex	(387.2)	(483.8)	(430.0)	(433.7)	(449.2)
Interest income	12.9	16.2	15.6	15.0	15.5
Others	(29.6)	(34.4)	0.4	0.4	0.4
Investing cash flow	(403.9)	(502.1)	(414.1)	(418.3)	(433.3)
Net share issue	269.6	0.0	0.0	0.0	0.0
Net borrowings	(7.2)	140.7	(50.0)	0.0	0.0
Dividend paid	(84.5)	(23.8)	(59.4)	(70.2)	(79.0)
Interest paid	(136.6)	(125.9)	(130.7)	(129.5)	(129.5)
Others	(43.3)	80.5	0.0	0.0	0.0
Financial cash flow	(2.1)	71.6	(240.1)	(199.7)	(208.5)
Net cash flow	264.6	(1.1)	(47.4)	(11.0)	59.2
Beginning Cash	390.4	654.2	645.8	598.4	587.4
Forex & others	(0.8)	(7.3)	0.0	0.0	0.0
Ending Cash	654.2	645.8	598.4	587.4	646.6

Earnings Summary – QL Resources

PROFIT & LOSS

FYE Mar 31 (RMmn)	FY19	FY20	FY21E	FY22F	FY23F
Revenue	3,619.2	4,152.8	4,598.3	5,051.4	5,553.4
EBIT	312.8	352.8	402.7	451.9	514.3
EBITDA	472.5	528.4	595.7	664.2	747.7
Reported PBT	272.4	306.9	347.4	394.9	457.3
Reported Net Profit	216.8	239.3	268.6	302.6	350.3
Adj net profit	216.8	239.3	268.6	302.6	350.3
Adj EPS (sen)	8.9	9.8	11.0	12.4	14.4
GDPS (sen)	3.0	3.0	3.3	3.7	4.0

CASH FLOW

FYE Mar 31 (RMmn)	FY19	FY20	FY21E	FY22F	FY23F
PBT	272.4	306.9	347.4	394.9	457.3
Adjustments for:					
Depreciation & amortisation	159.7	175.6	193.1	212.3	233.4
Interest expense	60.7	69.6	73.0	76.6	80.4
Share of JV & associates	(12.8)	(11.2)	(11.5)	(11.9)	(12.2)
Others	(25.4)	(3.0)	(6.2)	(7.7)	(11.2)
CFO before WC	454.5	538.0	595.7	664.2	747.7
Inventories	(196.6)	63.0	(136.3)	(63.7)	(70.5)
Receivables	(9.4)	(38.3)	(41.3)	(38.3)	(42.4)
Payables	118.6	41.7	43.7	40.9	45.4
Tax	(44.0)	(44.3)	(73.2)	(86.1)	(99.9)
Others	(31.4)	(121.7)	-	-	-
CFO	291.7	438.4	388.7	517.1	580.2
Acquisition & capex	(305.7)	(356.6)	(350.0)	(350.0)	(325.0)
Disposal	-	-	-	-	-
Others	8.9	-	6.2	7.7	11.2
CFI	(296.7)	(356.6)	(343.8)	(342.3)	(313.8)
Net borrowing	98.7	16.8	50.0	50.0	50.0
Interest paid	(41.0)	(69.6)	(73.0)	(76.6)	(80.4)
Dividend to shareholders	(73.0)	(73.0)	(81.1)	(89.2)	(97.3)
Others	(19.9)	63.3	-	-	-
CFF	(35.2)	(62.5)	(104.2)	(115.8)	(127.7)
Net cash flow	(40.2)	19.3	(59.3)	59.0	138.7

BALANCE SHEET

FYE Mar 31 (RMmn)	FY19	FY20	FY21E	FY22F	FY23F
PPE	1,961.4	2,135.3	2,292.2	2,429.9	2,521.5
Intangible assets	10.4	15.1	15.1	15.1	15.1
Investment in associates	138.9	142.5	154.0	165.9	178.1
Others	100.8	267.8	267.8	267.8	267.8
Non-Current Assets	2,211.4	2,560.6	2,729.1	2,878.7	2,982.5
Inventories	572.8	509.8	646.2	709.8	780.4
Receivables	308.9	347.2	388.5	426.8	469.2
Cash & equivalents	261.4	307.9	248.6	307.6	446.3
Others	329.1	343.6	343.6	343.6	343.6
Current assets	1,472.3	1,508.6	1,626.9	1,787.8	2,039.5
Assets	3,683.7	4,069.2	4,356.0	4,666.5	5,021.9
Loans & borrowings	590.0	661.9	681.9	701.9	721.9
Others	113.5	124.3	124.3	124.3	124.3
Non Current liabilities	703.5	786.2	806.2	826.2	846.2
Payables	330.1	371.8	415.5	456.5	501.8
Borrowings	596.6	645.4	675.4	705.4	735.4
Others	39.1	176.0	176.0	176.0	176.0
Current liabilities	965.8	1,193.2	1,266.9	1,337.9	1,413.2
Share capital	620.0	620.0	620.0	620.0	620.0
Reserves	1,315.0	1,399.8	1,587.3	1,800.7	2,053.6
Others	-	-	-	-	-
Total (ex MI)	1,935.0	2,019.8	2,207.3	2,420.7	2,673.6
Minority interest	79.3	70.0	75.5	81.7	88.8
Equity	2,014.3	2,089.8	2,282.8	2,502.4	2,762.5
Equity & Liabilities	3,683.7	4,069.2	4,356.0	4,666.5	5,021.9

FINANCIAL RATIOS

FYE Mar 31 (RMmn)	FY19	FY20	FY21E	FY22F	FY23F
PER (x)	68.0	61.6	54.9	48.7	42.1
P/NTA (x)	7.7	7.4	6.7	6.1	5.5
Dividend yield (%)	0.5	0.5	0.6	0.6	0.7
ROE (%)	11.6	12.1	12.7	13.1	13.8
ROA (%)	6.2	6.2	6.4	6.7	7.2
EBIT margin (%)	8.6	8.5	8.8	8.9	9.3
PBT margin (%)	7.5	7.4	7.6	7.8	8.2
Net margin (%)	6.0	5.8	5.8	6.0	6.3

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Sector Recommendation Guideline

OVERWEIGHT : The industry, as per our coverage universe, is expected to outperform the FBMKLCI over the next 12 months.

NEUTRAL : The industry, as per our coverage universe, is expected to perform in line with the FBMKLCI over the next 12 months.

UNDERWEIGHT: The industry, as per our coverage universe, is expected to underperform the FBMKLCI over the next 12 months.

Stock 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.

ESG Guideline

★★★★★ (≥80%) : Displayed market leading capabilities in integrating ESG factors in all aspects of operations, management and future directions.

★★★★ (60-79%) : Above adequate integration of ESG factors into most aspects of operations, management and future directions.

★★★ (40-59%) : Adequate integration of ESG factors into operations, management and future directions.

★★ (20-39%) : Have some integration of ESG factors in operations and management but are insufficient.

★ (<20%) : Minimal or no integration of ESG factors in operations and management.

Disclaimer

The information in this report has been obtained from sources believed to be reliable. Its accuracy and/ or completeness is not guaranteed and opinions are subject to change without notice. This report is for information only and not to be construed as a solicitation for contracts. We accept no liability for any direct or indirect loss arising from the use of this document. We, our associates, directors, employees may have an interest in the securities and/or companies mentioned herein.

As of Wednesday, April 07, 2021, 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

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