midf RESEARCH

27 Nov 2018 | 2QFY19 Results Review

QL Resources Berhad

Ramping up production of its surimi-based product

***Upgrade* to NEUTRAL**
(*Previously SELL*)
***Revised Target* Price (TP): RM7.35**
(Previously RM5.48)

INVESTMENT HIGHLIGHTS

- **2QFY19 earnings rose by +10.7%yoy to RM60.5m, premised on the recovery of the MPM segment**
- **This, however, was partially subdued by the poor performance from the ILF and POA segments**
- **Aggressive expansion plan in-store for FamilyMart to achieve the ultimate goal of opening 300 stores by FY22**
- **We change our valuation methodology to DCF from PER to reflect QL's long run profitability**
- **Upgrade to NEUTRAL with a revised TP of RM7.35**

Earnings within expectations. QL Resources Berhad (QL)'s 2QFY19 earnings came in at RM60.5m, an increase of +10.7%yoy. This is within our and consensus expectations, accounting for 48.5% and 45.8% of full year FY19 earnings forecasts respectively. The stronger earnings growth during the quarter was driven by the recovery of earnings from the Marine Product Manufacturing (MPM) segment. This mitigated the subdued performance of the Integrated Lifestock Farming (ILF) and Palm Oil Activities (POA) segment.

MPM segment's sales rose driven by production ramp-up. QL's biggest earnings contributor, the MPM segment recorded a strong 2QFY19 PBT growth of +21.0%yoy. The strong performance was mainly due to the higher sales volume of surimi-based products resulting from the: (i) recovery in fish catch; and (ii) production ramp-up of newly completed surimi-based product plants in Hutan Melintang. Moving forward, we are expecting that the contribution derive from the export of fishery products to continue to rise, partially supported by the relatively weaker ringgit.

Poor performance from ILF and POA segment. The ILF segment's 2QFY19 PBT dropped by -2.0%yoy mainly attributable to the lower contribution from Indonesian operation as a result of the depreciation in Rupiah against Ringgit. Meanwhile, POA segment recorded a loss of -RM1.6m mainly, impacted by the lower oil extraction rate (OER) as well as lower CPO price. We expect that the outlook for these two segments will continue to be challenging going forward.

RETURN STATS	
Price (26th November 2018)	RM7.21
Target Price	RM7.35
Expected Share Price Return	+1.9%
Expected Dividend Yield	+0.9%
Expected Total Return	**+2.8%**

STOCK INFO	
KLCI	1,701.99
Bursa / Bloomberg	7084 / QLG MK
Board / Sector	Main / Consumer
Syariah Compliant	Yes
Issued shares (mil)	1622.44
Market cap. (RM'm)	11,697.78m
Price over NA	6.27
52-wk price Range	RM3.93-RM7.63
Beta (against KLCI)	0.61
3-mth Avg Daily Vol	2.59m
3-mth Avg Daily Value	RM17.9m
Major Shareholders (%)	
CBG Holdings Sdn Bhd	41.29
Farsathy Holdings Sdn Bhd	11.77
EPF	5.52

Rapid expansion of FamilyMart's operation. QL has opened 73 FamilyMart stores after two years in operation since the opening of its 1st store in November 2016. By the end of FY19, the management is targeting the chain to have 90 stores to fulfil its ultimate goal of opening 300 stores by FY22. We gathered that the performance of this segment has been better than anticipated in terms of its gross margin, average ticket count and ticket size. Due to this, we believe that the segment will turn EBITDA positive earlier than the initial target in FY22.

Impact to earnings. We made no changes to our FY19 and FY20 earnings forecasts post earnings announcement as our current year forecast is still within expectation.

Target Price. We are changing our valuation method from PE multiples to DCF valuation method to take into account QL's long run profitability which is expected to be propelled by FamilyMart operation. Consequently, we derive a new target price of **RM7.35** (previously RM5.48) based on with assumption of terminal growth at 5.9% and WACC of 7.0%

Upgrade to NEUTRAL. We believe that the MPM segment will remain as the main earnings growth driver for the group in the short to medium term due to the: (i) ramp-up of production; and (ii) higher export revenue as a result of the recent weakening of Ringgit. Additionally, the segment's margin is the highest among QL's three operating segments and hence, its strong growth will contribute positively to the group's earnings. Over a longer term, we expect that expansion of FamilyMart operation will contribute to a positive free cash flow for the group starting from FY20. On the contrary, we expect the group's overall earnings growth will be partially impacted the ILF and POA segments. Due to the afore-mentioned reasons, we are upgrading our **NEUTRAL** recommendation (previously SELL) on the stock.

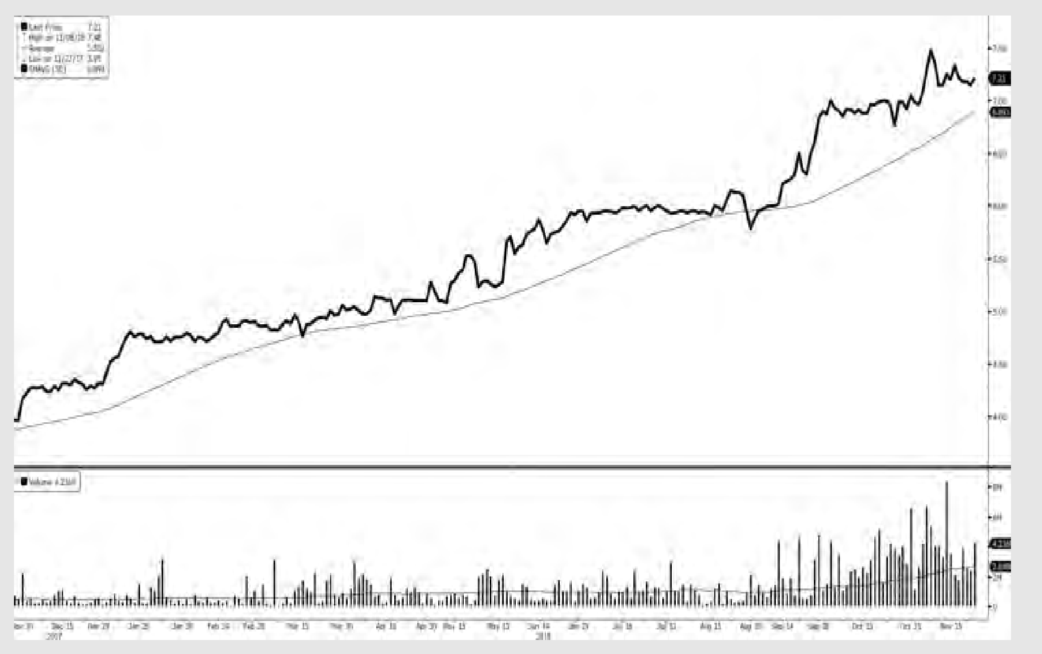
Recently, the stock was announced to be added into the MSCI Global Standard Indexes which will be implemented as of the close of 30 November 2018. Consequently, the stock is currently trading at PER of 47.1x which is approximately 85% premium on its historical five year historical PER of 25.5x. Therefore, we believe that all positivity has been priced at this current juncture.

INVESTMENT STATISTICS

FYE March (RM'm)	FY2016	FY2017	FY2018	FY2019F	FY2020F
Revenue	2,853.9	3,012.0	3,263.3	3,666.2	3,960.8
PBT	249.5	260.5	255.3	307.8	372.8
PATAMI	**192.1**	**195.2**	**205.5**	**246.2**	**298.2**
Basic EPS (sen)	11.8	12.0	12.7	15.2	18.4
Net DPS (sen)	4.3	7.3	4.5	5.4	6.5
PATAMI margin (%)	6.7	6.5	6.3	6.7	7.5
Basic EPS growth (%)	**0.4**	**1.6**	**5.3**	**19.8**	**21.1**
Net dividend yield (%)	0.6	1.0	0.6	0.7	0.9
PER (x)	60.9	59.9	56.9	47.5	39.2

Source: Company, MIDFR

DAILY PRICE CHART



Nabil Zainoodin, CFA, CA
nabil.zainoodin@midf.com.my
03-2772 1663

QL RESOURCES BHD: 2QFY19 RESULTS REVIEW

FYE March (RM'm)	Quarterly results			Cumulative results		
	2QFY19	YoY (%)	QoQ (%)	1HFY19	1HFY18	YoY (%)
Revenue	920.3	13.8	12.8	1,736.4	1,587.4	9.4
Operating Profit	113.5	7.8	20.2	208.0	194.7	6.9
Depreciation and amortisation	(35.6)	9.2	3.2	(70.1)	(64.6)	8.4
Interest income	2.5	(4.6)	30.6	4.3	3.4	27.9
Finance costs	(16.2)	33.9	23.7	(29.2)	(22.7)	28.9
Share of profit/(loss) of associates (net)	2.7	19.7	15.9	5.1	4.5	12.6
Profit before tax	**67.0**	**2.2**	**30.9**	**118.2**	**115.3**	**2.5**
Income tax expense	(5.5)	(31.7)	(26.7)	(13.0)	(14.3)	(9.1)
Profit after tax	**61.5**	**7.0**	**40.8**	**105.1**	**101.0**	**4.1**
Minority interests	1.0	(65.4)	(570.4)	0.8	4.3	(82.1)
PATAMI	**60.5**	**10.7**	**38.0**	**104.4**	**96.7**	**7.9**
Basic EPS (sen)	3.7	10.7	38.1	6.4	6.0	7.9
		+/(-) ppts	*+/(-) ppts*			*+/(-) ppts*
PBT margin (%)	7.3	(0.8)	(1.0)	6.8	7.3	(0.5)
PAT margin (%)	6.7	(0.4)	(1.3)	6.1	6.4	(0.3)
PATAMI margin (%)	6.6	(0.2)	(1.2)	6.0	6.1	(0.1)
Effective tax rate (%)	8.2	(4.1)	6.5	11.0	12.4	(1.4)
Segments						
Revenue						
Marine Product Manufacturing (MPM)	266.8	22.6	22.8	484.0	432.7	11.9
Palm Oil Activities (POA)	82.5	6.4	14.0	154.8	193.4	(20.0)
Integrated Livestock Farming (ILF)	571.0	11.1	8.4	1,097.6	961.4	14.2
Profit before tax (PBT)						
Marine Product Manufacturing (MPM)	39.1	21.0	26.7	70.0	63.0	11.0
Palm Oil Activities (POA)	(1.6)	(153.0)	(157.7)	1.2	8.8	(86.4)
Integrated Livestock Farming (ILF)	29.5	(2.0)	68.9	47.0	43.5	8.1
PBT margin (%)		*+/(-) ppts*	*+/(-) ppts*			*+/(-) ppts*
Marine Product Manufacturing (MPM)	14.7	(0.2)	(0.5)	14.5	14.6	(0.1)
Palm Oil Activities (POA)	(2.0)	(6.0)	5.9	0.8	4.5	(3.8)
Integrated Livestock Farming (ILF)	5.2	(0.7)	(1.9)	4.3	4.5	(0.2)

Source: Company, MIDFR

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.