Hup Seng Industries Berhad

(5024 | HSI MK) Main | Consumer Products & Services | Food & Beverages

***Maintain* BUY**

Steady Outlook

***Revised* Target Price: RM0.95**
(from RM0.90)

KEY INVESTMENT HIGHLIGHTS

- **Handling raw material price fluctuations**
- **Price hikes and margin sustainability**
- **E-commerce contribution remained insignificant**
- **Prudent capital expansion plan ahead**
- **Better dividend payout ahead**
- **Maintain BUY with a revised TP of RM0.95 (from RM0.90)**

Virtual meeting. We had a virtual meeting with Hup Seng Industries recently. Post meeting, we remain optimistic on outlook for Hup Seng Industries in the near-term. Here are the key highlights from meeting:

Handling raw material price fluctuations. Hup Seng is vulnerable to raw material price volatility via global commodity price indexes, owing to its substantial reliance on global commodities like as wheat for flour, CPO (Crude Palm Oil), and sugar. Notably, the company does not have hedging tools to mitigate this volatility. Moving forward, the group has highlighted its commitment to improving production cost efficiency to maintain margins at an acceptable level. Recall that the group purchased a new production line to replace the old machinery and increase production efficiency, achieving this through measures such as reducing fuel costs, improving quality and hygiene, minimizing waste, and environmentally reducing carbon emissions. Besides, the group also aims to reduce wastage to save costs.

Price hikes and margin sustainability. Management alludes that price increases are the final option for countering rising costs and sustaining profit margins. The company's threshold for considering such increases is a double-digit net profit margin, approximately at the 15% level. Recall that Hup Seng implemented a price hike in 2QFY22 to pass on increased costs to customers, with the last one prior to that occurring in 2010. While sales volumes initially dipped after the price increase, they gradually recovered within a year. This indicates that price hikes are only pursued as a last resort to manage heightened expenses. Looking ahead, the management does not foresee any further price hikes and aims to maintain profitability through effective cost management.

E-commerce contribution remained insignificant. Contribution from e-commerce stayed small, accounting for less than 5% of total FY22 net profit. Management highlighted that e-commerce serves primarily as a platform for selling products during the pandemic. Moving forwawrd, Hup Seng will continue to depend on its strong brick-and-mortar sales, capitalizing on its competitive advantage, which includes a robust distribution network with six branches across Malaysia and a sales team of over 80 individuals nationwide.

RETURN STATISTICS	
Price @ 21 Sept 2023 (RM)	0.70
Expected share price return (%)	+29.0
Expected dividend yield (%)	6.20
Expected total return (%)	**+41.86**

SHARE PRICE CHART

Price performance (%)	Absolute	Relative
1 month	1.4	1.7
3 months	10.2	7.0
12 months	0.7	0.1

INVESTMENT STATISTICS

FYE Dec	2023F	2024F	2025F
Revenue	334.6	352.3	372.1
EBITDA	56.8	70.7	86.5
Profit before tax (PBT)	49.5	65.9	82.8
Core PATANCI	36.4	48.5	60.9
Core EPS (sen)	4.5	6.1	7.6
DPS (sen)	4.3	5.8	7.2
Dividend Yield (%)	6.2	8.2	10.3

KEY STATISTICS	
FBM KLCI	1,448.21
Issue shares (m)	800.00
Estimated free float (%)	34.67
Market Capitalisation (RM'm)	560.00
52-wk price range	RM0.6 - RM0.80
3-mth average daily volume (m)	0.36
3-mth average daily value (RM'm)	0.24
Top Shareholders (%)	
HSB Group Sdn Bhd	51.00
Employees Provident Fund Board	2.44
Kerk Chian Tung	1.42

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Prudent capital expansion plan ahead. Hup Seng Group emphasizes its commitment to managing its capital expansion prudently, opting for significant capital expenditures only when deemed necessary. The company's primary focus remains on its core products. Notably, in 1QFY23, the group acquired a new production line using cash consideration.

Better dividend payout ahead. Management anticipates an enhanced dividend payout for FY23F, driven by the normalization of net profit following last year's price increase and declining raw material costs. Recall that historically, the group consistently maintained a robust dividend payout, exceeding 100% from FY17 to FY20. However, this payout dipped to 73% in FY21 due to the nationwide lockdown, as the group adopted a cautious approach towards spending and retained earnings for preparation. There was a noticeable improvement in FY22, with the payout reaching 92%.

No changes to FY23-25F earnings forecast but adjust dividend payout. We made no changes to our forecast following the virtual meeting. However, we raised our dividend payout forecast from 75% to 95% to reflect the normalization of net profit, which could lead to an increase in dividend payments by management.

Maintain BUY with a revised TP of RM0.94 (from RM0.90). Our revised **TP** is based on DDM valuation with an unchanged growth rate of 3.0% and an unchanged WACC of 10.0%. We continue to like Hup Seng, underpinned by its (1) relatively stable demand for its products thanks to its well-established household brand, (2) consistent dividend payout (over 70% for the past 8 years), and (3) a solid net cash position of RM72.3m as of 2QFY23. Moving forward, we anticipate a normalized profit margin, supported by the normalization of global commodity prices for wheat and CPO. While sugar prices have remained elevated, we have observed a recovery from their 2-year peak level. Hence, we maintain a **BUY** recommendation. Hup Seng Industries is currently trading at an attractive FY24F PER of 11.6x, which is below its 5-year historical mean PER of 18.6x and the sectoral PER for consumer staples under our coverage (excluding QL and Nestle), which is 17.9x.

The downside risk is a sharp increase in comodities price, especially CPO, sugar, and wheat flour.

FINANCIAL SUMMARY

Income Statement (RM'm)	2021A	2022A	2023F	2024F	2025F
Revenue	295.8	318.2	334.6	352.3	372.1
Cost of Sales	(214.2)	(239.9)	(239.7)	(238.1)	(237.6)
Gross Profit	**81.7**	**78.3**	**94.9**	**114.3**	**134.4**
Other Income	1.5	1.7	3.1	3.2	3.4
Selling and Distribution expenses	(27.4)	(27.4)	(29.1)	(30.9)	(33.0)
General & Administrative	(18.6)	(18.4)	(19.5)	(20.7)	(22.1)
EBITDA	**43.9**	**41.0**	**56.8**	**70.7**	**86.5**
EBIT	37.2	34.3	49.4	65.8	82.7
Profit before tax (PBT)	**38.2**	**35.4**	**49.5**	**65.9**	**82.8**
Income tax expense	(10.1)	(9.4)	(13.1)	(17.4)	(21.9)
Profit After tax (PAT)	28.1	26.1	36.4	48.5	60.9
Core PATANCI	**28.4**	**25.0**	**36.4**	**48.5**	**60.9**
Core EPS (sen)	3.5	3.1	4.5	6.1	7.6
DPS (sen)	2.5	3.0	4.3	5.8	7.2

Balance Sheet (RM'm)	2021A	2022A	2023F	2024F	2025F
Property, plant and equipment	72.8	72.7	80.3	82.9	84.4
Intangible assets	0.0	1.0	0.0	0.0	0.0
Total Non-current assets	**80.2**	**79.5**	**91.1**	**93.7**	**95.3**
Inventories	31.6	29.9	30.8	30.6	30.6
ST - Trade and other receivables	28.2	40.2	36.1	38.0	40.1
Cash and cash equivalents	66.7	62.4	65.7	69.1	73.0
Total current assets	**127.0**	**133.3**	**133.3**	**138.5**	**144.5**
Total Assets	**207.2**	**212.8**	**224.4**	**232.2**	**239.8**
Total Equity	139.0	141.1	137.9	137.8	139.1
LT Loans and borrowings	0.0	0.0	0.0	0.0	0.0
Total Non-current liabilities	**7.2**	**6.9**	**7.2**	**7.6**	**8.0**
ST Trade and other payables	56.3	58.3	57.5	57.1	57.0
ST Loans and borrowings	0.0	0.0	0.0	0.0	0.0
Total Current Liabilities	**60.9**	**64.9**	**79.3**	**86.8**	**92.8**
Total Liabilities	**68.1**	**71.7**	**86.5**	**94.4**	**100.8**

Cash Flow (RM'm)	2021A	2022A	2023F	2024F	2025F
Pretax profit	38.2	35.4	49.5	65.9	82.8
Cash flow from operations	**29.9**	**24.9**	**52.9**	**57.0**	**67.0**
Cash flow from investing	**2.5**	**(3.8)**	**(15.1)**	**(7.5)**	**(5.2)**
Cash flow from financing	**(44.3)**	**(24.3)**	**(34.6)**	**(46.1)**	**(57.9)**
Net cash flow	(11.9)	(3.2)	3.2	3.5	3.9
(+/-) Adjustments	0.0	0.0	0.0	0.0	0.0
Net cash/(debt) b/f	**77.5**	**65.7**	**62.4**	**65.7**	**69.1**
Net cash/(debt) c/f	**65.7**	**62.4**	**65.7**	**69.1**	**73.0**

Key Metrics	2021A	2022A	2023F	2024F	2025F
Effective tax rate (%)	26.3	26.4	26.5	26.5	26.5
PER (x)	20.5	21.5	15.4	11.6	9.2
Net Cash/Market Capitalisation (%)	11.9	11.2	11.7	12.3	13.0
P/BV ratio (x)	4.0	4.0	4.1	4.1	4.0
Cash/share (sen)	3.7	3.1	6.6	7.1	8.4

Profitability Margins	2021A	2022A	2023F	2024F	2025F
Gross Profit Margin (%)	27.6	24.6	28.4	32.4	36.1
EBIT Margin (%)	12.6	10.8	14.8	18.7	22.2
Core PATANCI Margin (%)	9.6	7.9	10.9	13.8	16.4

Source: Bloomberg, MIDFR

DISCLOSURES AND DISCLAIMER

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.
ESG RECOMMENDATIONS* - source Bursa Malaysia and FTSE Russell	
☆☆☆☆	Top 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆☆	Top 26-50% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆☆	Top 51%- 75% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell
☆	Bottom 25% by ESG Ratings amongst PLCs in FBM EMAS that have been assessed by FTSE Russell

* ESG Ratings of PLCs in FBM EMAS that have been assessed by FTSE Russell in accordance with FTSE Russell ESG Ratings Methodology