ESG Grading Band ★

midf RESEARCH

Leong Hup International Berhad

***Maintain* BUY**

(6633 | LHIB MK) Main | Consumer Products & Services| Agricultural Products

Solid Demand and Compelling Valuation

***Revised* Target Price: RM0.83**

(Previously RM0.90)

KEY INVESTMENT HIGHLIGHTS

- **Highly automated Feedmill Plant yet exposed to global commodity fluctuations with 90% of raw materials imported**
- **Expect lower feed costs ahead due to declining global corn and soybean meal prices**
- **Revised earnings forecast for FY23F-25F after factoring in slightly lower revenue in Indonesia**
- **Maintain BUY with a revised TP of RM0.83 (from RM0.90)**

Largest fully integrated poultry producer in Southeast Asia. Leong Hup International ("LHI") is the largest fully integrated producer in the entire poultry supply chain. It covers livestock feed production, poultry breeding, broiler farming, layer production, the development of further processed poultry products, and quick-service restaurants. This comprehensive approach enables the group to balance downside risks at different stages of the value chain through diverse operations. LHI operates not only in Malaysia and Singapore but also in other fast-growing countries in Southeast Asia like Indonesia, Vietnam, and the Philippines. This widespread presence not only mitigates potential risks in specific operations but also positions LHI to capture a significant market share in the underserved demand for poultry products.

Visited Upstream and Midstream Value Chain. We recently visited Leong Hup's upstream business, specifically the Feedmill plant, and the midstream business of the broiler farm at Sungkai Perak. Salient highlights are as follows: -

Highly automated Feedmill Plant yet exposed to global commodity fluctuations with 90% of raw materials imported. The Leong Hup Feedmill Plant at Port Klang is highly automated, operating with a lean workforce of 18 people per shift with 3 shifts per day. Meanwhile, the raw material costs account for a substantial 83-85% of the total production cost for livestock feed. Livestock feed formulation involves 25-40 ingredients, with the composition varying based on the life cycle and type (broiler or layer) of the livestock. Notably, 90% of these ingredients are sourced internationally, with corn (50%) and soybean meal (28%) being the primary contributors. We expect that the impact of global agricultural commodity fluctuations on LHI's feed mill business is manageable due to its cost-plus-margin model, as any increase in raw material costs is passed on to the livestock producer (customer of feed mill). In Malaysia, 70% of the feed produced in LHI's feed mill is for internal use (usually sold in bulk), while the remaining 30% is for other poultry players, either packed in 50kg bags or in bulk based on customer orders and the type of the farmhouse.

RETURN STATISTICS	
Price @ 24th Jan 2024 (RM)	0.55
Expected share price return (%)	+50.96
Expected dividend yield (%)	+5.30
Expected total return (%)	**+56.43**

SHARE PRICE CHART

Price performance (%)	Absolute	Relative
1 month	-4.3	-7.5
3 months	-2.7	-15.6
12 months	6.8	6.5

INVESTMENT STATISTICS

FYE Dec	2023F	2024F	2025F
Revenue	9,550.1	9,783.9	10,051.3
EBITDA	**909.6**	**906.0**	**933.5**
Profit before tax (PBT)	473.3	481.6	526.2
Core PATANCI	**304.2**	**361.2**	**394.6**
Core EPS (sen)	8.3	9.9	10.8
DPS (sen)	2.9	3.0	3.2
Dividend Yield (%)	5.3	5.4	5.9

KEY STATISTICS	
FBM KLCI	1,504.10
Issue shares (m)	3650.00
Estimated free float (%)	17.97
Market Capitalisation (RM'm)	2,007.50
52-wk price range	RM0.4-RM0.73
3-mth average daily volume (m)	6.35
3-mth average daily value (RM'm)	3.93
Top Shareholders (%)	
Emerging Glory Sdn Bhd	52.80
Amanah Saham Nasional Bhd	7.07
CLARINDEN INV PTE	6.21

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Indonesia's Feed costs always a bit extra. Indonesia's feed prices per kg are always more expensive than Malaysia's, mainly due to the restriction of sourcing feed corn only from local suppliers, as per our previous report, MIDF Research Thematic Report: Indonesia in Post-Jokowi Era; Malaysia Perspective. Despite these stringent regulations, there have been instances where the government authorized the National Logistics Agency (BULOG), under the directive of the National Food Agency (NFA), to import feed corn during periods of exceptionally high local prices and limited supply for smaller domestic poultry farmers. Based on our channel checks, the current price of corn in Indonesia is trending above global corn prices (attributed to a lack of economies of scale) and surpasses the government's reference price for corn. This is mainly due to the tight domestic corn supplies resulting from the El Niño phenomenon in 2023, which adversely affected local corn production yields. While Leong Hup Feedmill in Indonesia has successfully passed on increased costs to livestock players, its midstream operations in Indonesia (including broiler, breeder, and commercial layer farms) have been operating at a higher cost compared to other regional operations. Looking ahead, we anticipate that feed costs in Indonesia will remain elevated due to the prolonged El Niño phenomenon, expected to persist into 1QCY24. This sustained weather pattern will continue to tighten corn supplies, resulting in corn prices at elevated levels. Hence, feed costs in Indonesia are expected to remain more expensive than those of other regional players, especially Malaysia.

Expect lower feed costs ahead due to declining global corn and soybean meal prices. As of 23 January 2024, both corn and soybean meal continue to trend below the 2-year peak level, indicating lower livestock feed costs in the future. This, in turn, would benefit Leong Hup, given that corn and soybean meal are the key ingredients in livestock feed. Going forward, we expect lower feed costs for Leong Hup International, in tandem with the downward trend of global corn and soybean meal prices. We estimate that for every -10% decrease in global corn prices, the average livestock feed price per kilogram is expected to reduce by -4.3%, and vice versa, assuming no changes in other costs and the USD/MYR exchange rate. Similarly, for every -10% drop in global soybean meal prices, we anticipate a -2.4% decrease in feed prices per kilogram, assuming no changes in other costs and the USD/MYR exchange rate.

Storage and bulk grain purchases minimize short-term supply chain risks. The recent disruptions in the global supply chain, stemming from the Red Sea crisis and prolonged congestion in Brazil's major port, are expected to be manageable. LHI has sufficient storage for raw materials, boasting eight silos in its feed mill plant at Port Klang, each with a capacity of 2,500mt. The consistent Panamax vessels, which transport global commodities for feed to Port Klang, Malaysia, at a rate of approximately 6-7 vessels per month, each with a 60,000 metric ton capacity, remain a reliable source to ensure the sustainable supply of raw materials for feed in Malaysia. Meanwhile, we gather that LHI is one of the largest buyers from vessels at Port Klang, acquiring 33% of the total grains carried per vessel. With abundant storage at Port Klang and a predominant role as the primary feed raw material buyer, we believe that Leong Hup Feedmill Plant in Port Klang is well-positioned to guarantee a plentiful supply of feed for both internal use and external customers in Malaysia.

Diversified farm operations with closed-Housed systems reduced the exposure to the livestock's diseases. We recently visited the broiler farm at Sungkai Perak and gathered that all Leong Hup's internally managed broiler, breeder farm and commercial layer farm are closed house. This enhances flock management by providing better control over biosecurity and climate factors that directly impact poultry growth and health. The closed house system also mitigates the risk of disease transmission, particularly through open-air exposure from external birds and the potential outbreak of influenza within its internally operated farms and facilities. Note that in the event of any outbreak of any livestock diseases such as Avian Influenza or Newcastle at any of Leong Hup facilities will have an adverse effect on the revenue and the profitability. The group further diversified the risk across regions including both internally managed and outsourced farms. As of FY22, LHI boasts a network of 851 contract farmers spanning Malaysia, Indonesia, Vietnam, and the Philippines. This extensive network serves to diversify and mitigate risks associated with livestock diseases, ensuring a robust and resilient approach to poultry farming.

Any water supply disruption will have an impact on the group's operations across farms and facilities. With various water supply disruption issues occurring across Malaysia, we acknowledge that the country is facing water challenges attributed to the increasing water demand, poor river basin management, and population growth. Meanwhile, water is indeed a critical resource in Leong Hup's operations, particularly in the broiler segment. We believe that any disruption to the water supply at a specific operation will impact the business. We gather that the broiler farm at Sungkai farm, Perak, sources water from wells (groundwater) to meet the water consumption needs of the farm. However, the broiler operation not only uses water for the intake of broiler chickens but also employs surface wetting through sprinklers on the chickens. This practice helps to cope with warm weather sustainably and efficiently, reducing the risk of heat stress. Additionally, the group utilizes water spraying on broiler chickens shortly before transportation to minimize the effects of transportation stress. The availability of water is crucial for the day-to-day operation of the group to ensure the comfort and health of the broiler chickens, indirectly boosting productivity. Therefore, we believe that any disruption to the water supply at any operation will pose a downside risk to the group's overall operations.

Continued weakening demand for poultry products in Indonesia amidst declining purchasing power. The Indonesia National Layer Breeders Association reported a notable phenomenon of early culling of layer breeders, driven by escalating production costs (due to high feed corn price in Indonesia) and a reduction in people's purchasing power. We noticed a significant downturn in the average monthly prices of live birds and Day-Old Chicks (DOC) in the Java area of Indonesia, following its peak in June and July 2023. This downturn underscores the prolonged sluggishness in consumer demand within the country in the near term. Note that Java contributed 50% to the poultry market in Indonesia. Looking ahead to the mid-to-long term, we are positive on Leong Hup's potential to capitalize on the growing demand for poultry-related products in Indonesia. This is given that Indonesia's population is nearly eight times greater than that of Malaysia, yet the poultry consumption per capita in 2022 was merely 8.21kg, significantly below Malaysia's 50.2kg.

Revised earnings forecast for FY23F-25F after factoring in slightly lower revenue in Indonesia. Given the persistent oversupply situation in Indonesia, where the prices of live birds and Day-Old Chicks (DOC) in Java plummeted to January 2023 levels, we have adjusted our FY23F-24F earnings forecast downward by -9.7%/-7.3%/-5.9% respectively. This is after factoring the reduced sales of livestock and poultry products in Indonesia.

Cheap valuation and high dividend yield. Leong Hup is currently trading at a FY24F PER of 5.4x, significantly below the 5-year historical -1SD PER of 8.4x. Nevertheless, the FY24F dividend yield is very attractive at 5.30%, well above the current 10-year MGS yield of 3.81%.

Maintain BUY with a revised TP of RM0.83 (from RM0.90). Our revised **TP** is based on an unchanged PER of 8.4x (5-year historical -1SD PER) pegged to a revised FY24F EPS of 9.9sen (up from 10.68sen). Despite facing multiple headwinds, we are positive about Leong Hup's FY24F outlook, underpinned by (1) the resilient demand for poultry products due to the staple food nature of its product (2) the normalization of margins for its Malaysian operations following removal of price controls for broiler chicken, and (3) the global softening of commodity prices for livestock feed, thereby improving the margin for the livestock segment. Hence, we maintain our **BUY** call on Leong Hup. **Downside risks** include (1) significant raw material cost increases, (2) adverse regulatory changes like price controls or culling programs, (3) shortages of great-grandparent DOC, and (4) disease outbreaks.

FINANCIAL SUMMARY

Income Statement (RM'm)	2021A	2022A	2023F	2024F	2025F
Revenue	**7,153.5**	**9,042.7**	**9,550.1**	**9,783.9**	**10,051.3**
Change in biological assets	42.8	7.9	67.1	(3.0)	10.7
Change in closing inventories	228.6	29.6	44.9	(6.7)	23.6
Purchase of inventories and livestock	(5,514.4)	(6,865.4)	(7,105.6)	(7,061.1)	(7,217.9)
Gross Profit	**1,910.5**	**2,214.8**	**2,556.4**	**2,713.0**	**2,867.8**
Other Income	39.1	188.8	149.5	35.5	36.5
Employee benefit costs including Directors' remuneration	(645.8)	(677.4)	(715.1)	(740.3)	(792.9)
Utilities costs	(185.6)	(221.4)	(280.6)	(286.0)	(304.1)
Repair and maintenance	(80.0)	(91.2)	(116.5)	(119.4)	(122.6)
Transportation expenses	(149.9)	(181.4)	(193.5)	(204.2)	(247.5)
Other operating expenses	(366.7)	(467.0)	(490.7)	(492.7)	(503.6)
EBIT	**237.9**	**464.0**	**632.2**	**625.8**	**650.5**
Profit before tax (PBT)	**140.3**	**326.6**	**473.3**	**481.6**	**526.2**
Profit After tax (PAT)	95.9	243.9	355.0	361.2	394.6
Core PATANCI	**88.2**	**240.6**	**304.2**	**361.2**	**394.6**
Core EPS (sen)	2.4	6.6	8.3	9.9	10.8
DPS (sen)	0.7	1.8	2.9	3.0	3.2

Balance Sheet (RM'm)	2021A	2022A	2023F	2024F	2025F
Property, plant and equipment	2,770.3	2,784.5	2,759.6	2,699.6	2,636.9
Total Non-current assets	**3,411.2**	**3,431.8**	**3,401.1**	**3,344.3**	**3,285.3**
Inventories	973.5	1,025.9	1,070.7	1,064.0	1,087.6
ST - Trade and other receivables	740.1	823.2	915.8	938.2	963.8
Cash and cash equivalents	764.6	840.3	798.7	810.1	823.9
Total current assets	**2,918.6**	**3,160.4**	**3,326.2**	**3,351.6**	**3,426.9**
Total Assets	**6,329.8**	**6,592.2**	**6,727.3**	**6,695.9**	**6,712.3**
Total Equity	**2,359.8**	**2,589.6**	**2,972.0**	**3,075.0**	**3,200.3**
LT Loans and borrowings	1,054.6	1,046.4	943.5	896.3	851.5
Total Non-current liabilities	**1,321.4**	**1,339.5**	**1,251.3**	**1,211.0**	**1,174.1**
ST Trade and other payables	534.7	629.8	623.0	619.1	632.8
ST Loans and borrowings	2,070.1	1,986.3	1,831.5	1,739.9	1,652.9
Total Current Liabilities	**2,648.5**	**2,663.1**	**2,504.1**	**2,409.8**	**2,337.9**
Total Liabilities	**3,970.0**	**4,002.6**	**3,755.4**	**3,620.8**	**3,512.0**

Cash Flow (RM'm)	2021A	2022A	2023F	2024F	2025F
Pretax profit	140.3	326.6	473.3	481.6	526.2
Cash flow from operations	44.2	620.9	1,092.2	695.1	684.4
Cash flow from investing	(392.6)	(277.6)	(286.2)	(257.1)	(257.3)
Cash flow from financing	264.3	(362.1)	(563.4)	(426.7)	(413.3)
Net cash flow	**(84.1)**	**(18.8)**	**242.6**	**11.4**	**13.8**
(+/-) Adjustments	13.4	(0.3)	0.0	0.0	0.0
Net cash/(debt) b/f	**645.8**	**575.1**	**556.1**	**798.7**	**810.1**
Net cash/(debt) c/f	**575.1**	**556.1**	**798.7**	**810.1**	**823.9**

Key Metrics	2021A	2022A	2023F	2024F	2025F
Effective tax rate (%)	31.7	25.3	25.0	25.0	25.0
PER (x)	23.5	9.2	5.7	5.6	5.1
Net debt/total equity (%)	1.0	0.8	0.7	0.6	0.5

Profitability Margins	2021A	2022A	2023F	2024F	2025F
Gross Profit Margin (%)	26.7	24.5	26.8	27.7	28.5
EBIT Margin (%)	3.3	5.1	6.6	6.4	6.5
Core PATANCI Margin (%)	1.2	2.7	3.2	3.7	3.9

Source: Bloomberg, 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.
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