Company Update | Monday, 08 August 2022

Leong Hup International Berhad

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

Maintain NEUTRAL

***Unchanged* Target Price: RM0.47**

Provisionally in violation of the Competition Act 2010

KEY INVESTMENT HIGHLIGHTS

- **Notice of proposed decision by Malaysia Competition Commission (MyCC)**
- **Leong Hup stated the anticipated financial penalty and proposed directions are not yet final**
- **Worst case scenario**
- **Earnings remain unchanged for FY22-24F**
- **Maintain NEUTRAL with an unchanged TP of RM0.47**

Notice of proposed decision by Malaysia Competition Commission (MyCC). Leong Hup Feedmill Malaysia Sdn Bhd (LFM) and four other feed millers were notified last Friday that they had been provisionally determined to have violated Section 4 of the Competition Act 2010 (Act 712). Note that LFM is an entirely owned subsidiary of Leong Hup International Berhad (LHIB), which engaged in the production and sale of animal feed as well as the provision of transportation services.

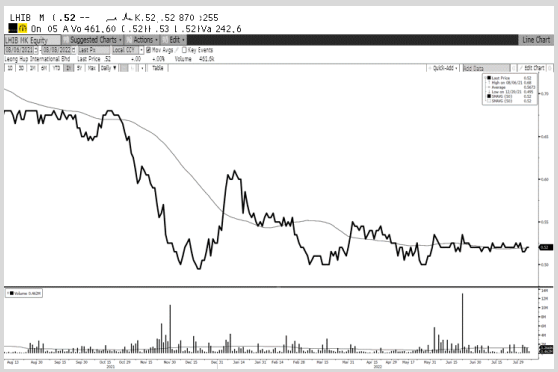
Basis. The notice claimed that LFM allegedly participated in anti-competitive agreements and/or coordinated actions in raising the price of poultry feed, between early 2020 and mid-2022. Based on section 4(1) of the Act, it is prohibited for businesses to enter into a horizontal or vertical agreement, if it significantly lessens, prevents, or distorts competition in any market for goods or services.

Bourse fillings. Leong Hup stated the anticipated financial penalty and proposed directions are not yet final. The group will address the matter with an external legal counsel, submit written representations within the allotted 30-day time frame, and give an oral argument before MyCC. After hearing and considering the representations along with the evidence acquired throughout the investigation, MyCC will then make its final decision about whether the Act was violated or not.

Not a good case? The group contended that the cost hikes of feed millers is mainly due to Malaysian feed mills importing the same raw materials from overseas. This is due to oligopoly structure of feedmill, where businesses manufacture homogeneous products at a fixed marginal cost. Feed millers compete by establishing pricing such that when one increases, the others follow suit. Hence, the group emphasizes that just because all increase around the same time does not equate to price fixing.

RETURN STATISTICS	
Price @ 5th August 2022 (RM)	0.52
Expected share price return (%)	-9.57
Expected dividend yield (%)	+0.00
Expected total return (%)	**-9.57**

SHARE PRICE CHART



Share price performance (%)	Absolute	Relative
1 month	0.0	-5.0
3 months	0.0	3.2
12 months	-23.5	-24.1

KEY STATISTICS	
FBM KLCI	1,501.55
Syariah compliant	No
Issue shares (m)	3650.00
F4BGM Index	No
ESG Grading Band (Star rating)	☆
Estimated free float (%)	17.43
Market Capitalisation (RM'm)	1,898.00
52-wk price range	RM0.49 - RM0.70
Beta vs FBM KLCI (x)	0.56
Monthly volatility (%)	17.36
3-mth average daily volume (m)	1.22
3-mth average daily value (RM'm)	0.64
Top Shareholders (%)	
Emerging Glory Sdn Bhd	52.80
CLARINDEN INV PTE	8.56
Amanah Saham Nasional Bhd	7.07

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Worst case scenario. Based on section 40(1) of the act, if MyCC has determined that section 4 has been violated after the hearing, the commission may impose a financial penalty of not to exceed 10% of the group's feed mill revenue for the relevant period. We expect a worst-case financial penalty of between RM74.4m-RM744.4m premised on a financial penalty of between 1%-10% of LHIB's feed mill revenues from early 2020 to mid-2022 (Exhibit 1). Note that LHIB only operates feed mill in Malaysia. The financial penalty could potentially drag LHIB's FY22 revenue by -0.9 to -9.0% and net earnings by -63.0% to -633.0%.

Maintain NEUTRAL with an unchanged TP of RM0.47. We kept our earnings estimate, given that the findings are provisional and the proposed direction has not yet been decided. Meanwhile, we maintain our **TP** at **RM0.47**. Our TP is based on EPS of 3.2 sen at a PER of 14.6x for the FY22E (-1SD of its 2-year historical average). We are aware that the margin compression will continue in the near term on the back of the Feedmill's continued high raw material prices along with the price controls for chicken and eggs in Malaysia. Despite that, we are positive about LHI's long-term prospects, underpinned by its: (i) vertical integration of poultry, eggs, and livestock feed; and (ii) geographical diversification across Malaysia, Singapore, Indonesia, Vietnam, and the Philippines. Hence, we maintain our **NEUTRAL** call on LHIB.

INVESTMENT STATISTICS

Financial year ending 31st Dec (in RM'm, unless otherwise stated)	FY2020	FY2021	FY2022E	FY2023F	FY2024F
Revenue	6,040.7	7,153.5	8,226.5	8,473.3	8,727.5
Core EBITDA	**542.0**	**536.1**	**580.8**	**784.2**	**772.9**
Depreciation &amortisation	(259.4)	(283.7)	(304.7)	(343.3)	(353.6)
Core EBIT	**282.6**	**252.3**	**276.1**	**441.0**	**419.3**
Finance costs	0.4	(112.4)	(115.2)	(186.4)	(192.0)
Share of profits of associates	0.4	0.4	0.5	0.5	0.5
PBT	157.1	140.3	161.4	255.1	227.8
PAT	117.5	95.8	121.7	192.3	171.7
PATANCI	**113.1**	**85.3**	**117.6**	**103.0**	**79.7**
EPS (sen)	3.1	2.3	3.2	2.8	2.2
EPS growth (%)	(26.7)	(24.5)	37.7	(12.5)	(22.6)
Net Dividend (sen)	0.6	0.0	0.0	0.0	0.0
EBITDA margin (%)	9.0	7.5	7.1	9.3	8.9
PATANCI margin (%)	1.9	1.2	1.4	1.2	0.9
Dividend yield (%)	1.5	0.0	0.0	0.0	0.0
PER (x)	16.1	21.4	15.5	17.7	22.9

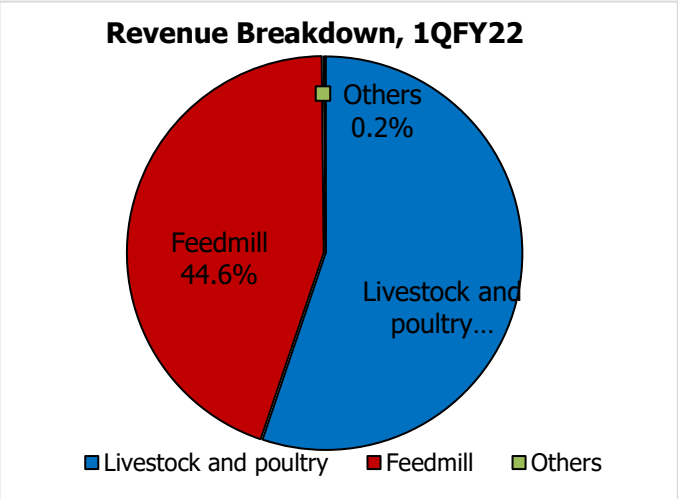
Source: Company, MIDFR

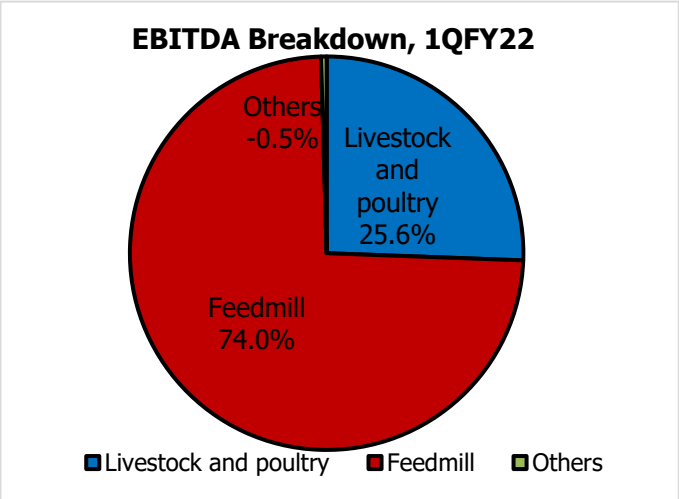
Exhibit 1: Sensitivity Analysis on potential financial penalty on FY2022

	Revenue (RM'm)
FY2020	2,654.5
FY2021	3,227.0
1HFY2022F	1,563.0
Total	**7,444.6**

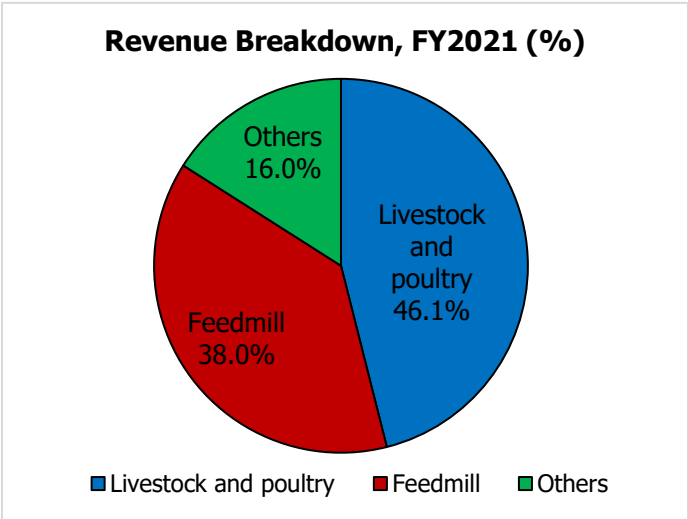
Estimated Penalty	1.0%	2.0%	3.0%	4.0%	5.0%	6.0%	7.0%	8.0%	9.0%	10.0%
Penalty (RM'm)	74.4	148.9	223.3	297.8	372.2	446.7	521.1	595.6	670.0	744.5

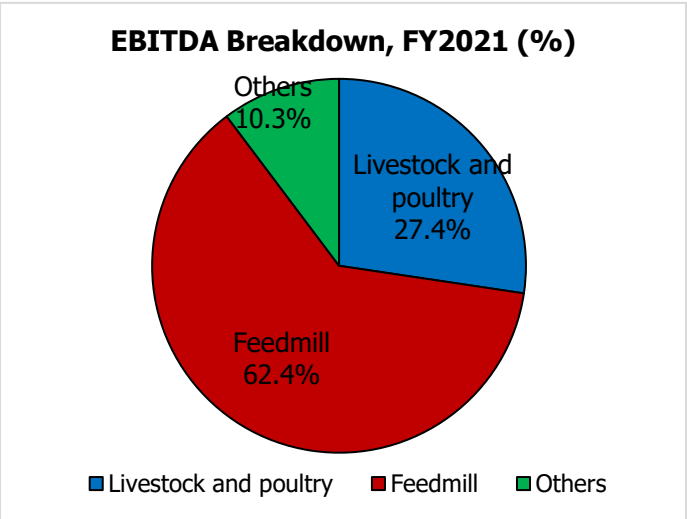
REVENUE & EBITDA BREAKDOWN BY SEGMENTS AS OF 1QFY22





REVENUE & EBITDA BREAKDOWN BY SEGMENTS AS OF FY2021





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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